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Compound Interest

A Consultation Paper

Law Commission
Consultation Paper No 167

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This consultation paper, completed on 31 July 2002, is circulated for comment and criticism only. It does not represent the final views of the Law Commission.

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THE LAW COMMISSION

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PART I
INTRODUCTION

1.1 As Item 4 of our Seventh Programme of Law Reform[1] we recommended an examination of the courts' power to award compound interest.

1.2 At present the courts have a statutory discretion to award interest on a debt or damages for which proceedings have been issued. However, the statutory power is specifically limited to simple interest, and does not extend to interest on sums paid late but before the issue of proceedings.

1.3 In certain cases statute provides that interest will run on a particular debt as of right. Examples are interest on tax and the creditor's right to interest on unpaid commercial debt under the Late Payment of Commercial Debts (Interest) Act 1998. In all these cases only simple interest is available.

1.4 Apart from these statutory powers, there is no general right to interest, simple or compound, at common law. There is a limited non-statutory jurisdiction to award interest in certain special cases: first, where the parties have agreed, expressly or impliedly, that interest shall be payable; secondly, where the interest is claimed by way of special damages as the consequence of a breach of contract; and thirdly, in equity, in cases of profits made from a fiduciary position or by fraud. In each of these three cases the interest may, depending on the circumstances, be awarded at simple or compound rates.

1.5 In *Westdeutsche Landesbank Girozentrale v Islington LBC*,[2] concerning restitution of money paid under a void swap transaction, the House of Lords rejected the possibility of awarding compound interest on debts by use of an equitable power, as this would by-pass the statutory restriction. They appeared to consider that, were it not for this, it would have been appropriate to award compound interest in these cases, but that any reform should be effected by statute. The main purpose of this Consultation Paper is to consider the clear invitation made in that decision.

1.6 In addition, arbitrators have been given power to award compound interest by section 49 of the Arbitration Act 1996. It appears anomalous that the courts should not have the same power that is conferred on arbitrators.

1.7 There are three policy options:

(1) One is to leave the law in its existing form. This decision could be taken either on the ground that awarding compound interest is wrong in principle or on the ground that, while it would be theoretically preferable to allow compound interest, the balance of convenience is against any change.

[1] Law Commission's Seventh Programme of Law Reform (1999) Law Com No 259, page 11; Eighth Programme of Law Reform (2001) Law Com No 274, page 10.

[2] [1996] 1 AC 669.

(2) The second is to amend the relevant statutes to confer on the courts a general power to award interest, simple or compound, and leave the courts to develop their own principles on when and how this power should be used.

(3) The third is to enact a prescriptive regime specifying in what cases compound interest should be awarded, and providing for the rates and the rests to be prescribed by regulations or otherwise.

For reasons that will be explained in Part IV, our provisional proposal is that compound interest be made available in all money judgments, and that unless there are good reasons to the contrary this should be awarded at prescribed rates as a matter of course.

1.8 Part II of this paper contains a description of the existing law and practice on the award of interest, simple or compound, in court judgments. Part III describes the law and practice of some other countries, some proposals for law reform in common law countries and some international initiatives for the harmonisation of the law. Part IV discusses the desirability of compound interest in principle, and the issues arising in connection with the various possibilities for reform. Part V lists our provisional proposals and invites comments on them.

1.9 This Consultation Paper is primarily the product of the Commission's own research. Certain questions were however circulated, and selected passages shown for comment, to selected judges and practitioners. We are particularly grateful to Mr Justice Etherton, Mr Justice David Steel, Chief Master Winegarten, the Association of District Judges, District Judge Carlos Dabezies, George Bartlett QC (the President of the Lands Tribunal), Nigel Teare QC, V V Veeder QC, Elizabeth Jeary (of the Court Funds Office), Professor Dr Ulrich Drobnig of the Max Planck Institute, Professor Bénédicte Fauvarque-Cosson of the University of Paris V and Professor Carlo Castronovo of the Università Cattolica del Sacro Cuore. The contents of this Consultation Paper are of course the sole responsibility of the Law Commission.

PART II
THE PRESENT LAW

INTRODUCTION

2.1 In order to make the present law comprehensible, it will be necessary first to explain the circumstances in which courts can award interest, and then whether in each case that interest can be compound. Interest is either pre-judgment or post-judgment: this Consultation Paper addresses only pre-judgment interest.

2.2 The main categories of pre-judgment interest are as follows:

(1) The statutory discretion: when proceedings are brought for debt[1] or damages,[2] simple interest is available from the date on which the cause of action arose until judgment, or until payment in the case of any amount paid after the commencement of the action but before judgment.[3] There is no power to award interest on amounts paid late but before the commencement of the action.

(2) Special cases where statutory simple interest is available as of right: for example, interest on tax,[4] and interest on unpaid commercial debt under the Late Payment of Commercial Debts (Interest) Act 1998.[5]

(3) Special cases other than under statute: interest under a contract or trade usage,[6] damages representing interest paid[7] and interest under the equity[8] and Admiralty[9] jurisdictions. These may be simple or compound according to the circumstances.

Independently of any pre-judgment interest, post-judgment interest under the Judgments Act 1838, at simple rates, runs on the amount of the judgment debt for the period from judgment until payment. This interest runs on the entire amount for which judgment is given, including any pre-judgment interest; so to this extent there is "one-off" compounding of interest.

[1] Para 2.18 below.

[2] Para 2.32 below.

[3] Supreme Court Act 1981, s 35A; County Courts Act 1984, s 69.

[4] Para 2.20 below.

[5] Paras 2.24 to 2.31 below.

[6] Paras 2.10 to 2.14 below.

[7] Para 2.15 below.

[8] Paras 2.35 to 2.41 below.

[9] Para 2.34 below.

HISTORY

2.3 It was held in *London, Chatham and Dover Railway Co v South Eastern Railway Co*[10] that at common law there is no interest on debts unless the contract or the customs of the trade provide that there should be. The main exception was that created by section 28 of the Civil Procedure Act 1833[11] (Lord Tenterden's Act), which provided that a jury could award interest on fixed debts under a written instrument, from the date specified for payment in the instrument or the date of written demand. The rationale was that interest only began to run when payment was late, so that this kind of interest was in the nature of damages for wrongfully withholding payment.[12] There was never any question of interest on damages,[13] and the possibility was not raised in the *London, Chatham and Dover Railway Co* case or any of the cases there cited.

2.4 Following the Second Interim Report of the Law Revision Committee[14] it was provided by section 3 of the Law Reform (Miscellaneous Provisions) Act 1934 that any judgment for debt or damages could include interest on the sum awarded: the section specifically provided that this power did not extend to the awarding of interest upon interest. This provision superseded section 28 of the 1833 Act, which was repealed. The 1934 Act did not provide for interest on sums already paid before judgment, or for sums payable under default judgments, as it only extended to cases where the claim had been "tried".

2.5 In 1978 the Law Commission recommended that statutory interest on a liquidated debt be available as of right from the agreed date for payment, or, where there is no agreed date, from 28 days after service of a formal demand on the debtor.[15] This would have the effect of allowing interest on sums paid before the commencement of proceedings. Interest on damages, or on debt for periods not covered by the demand procedure, would remain discretionary, and would not be given on sums paid before the commencement of proceedings. It would however be available when the judgment was given without the case having been tried, or where all or part of the sum awarded had been paid after the issue of proceedings but before judgment. The report decided against allowing compound interest, either in the statutory or the discretionary form. This part of the report was

[10] [1893] AC 429 (HL).

[11] 3 & 4 Will 4 c 42.

[12] At common law late payment damages in the form of interest were only available in the case of a debt on a negotiable instrument (para 2.14 below): *De Havilland v Bowerbank* (1807) 1 Camp 50, 170 ER 872; *Calton v Bragg* (1812) 15 East 223, 104 ER 828; *Higgins v Sargent* (1823) 2 B & C 350, 107 ER 414; *Page v Newman* (1829) 9 B & C 378, 33 RR 204, 109 ER 140; *Foster v Weston* (1830) 6 Bing 709, 130 ER 1454.

[13] With the doubtful exception of *Trelawney v Thomas* (1789) 1 H Bl 303, 126 ER 178, which allowed interest on disbursements: the effect of this was reversed by the decisions listed in the previous footnote.

[14] (1934) Cmd 4546.

[15] Report on Interest (1978) Law Com No 88; Cmnd 7229.

extremely brief and rejected compound interest mainly on the ground of complexity of calculation.[16]

2.6 This report was implemented in part by the Administration of Justice Act 1982, which inserted a new section 35A into the Supreme Court Act 1981 and a new section 97A into the County Courts Act 1959: on the consolidation of the County Courts Act this was reproduced as section 69 of the County Courts Act 1984. The proposal for statutory interest on debts was not implemented. Otherwise the proposed reforms to discretionary interest were effected more or less in the form suggested. The present law, as constituted by the new sections, is set out in detail in paragraphs 2.18 (debts) and 2.32 (damages). A Parliamentary initiative to introduce compound interest into the Bill was rejected, again on the ground of complexity.[17]

2.7 In *President of India v La Pintada Compania Navigacion SA*,[18] concerning late payment of freight and demurrage, the House of Lords declined to reverse their decision in *London, Chatham and Dover Railway Co v South Eastern Railway Co*,[19] either so as to give interest on sums paid before the commencement of proceedings or so as to give compound interest. Similarly in *Westdeutsche Landesbank Girozentrale v Islington LBC*,[20] concerning restitution of money paid under a void swap transaction, the House of Lords rejected the possibility of awarding compound interest on debts by use of an equitable power. In both cases the reasoning was that the proposed common law or equitable power would co-exist uneasily with the statutory power under section 35A of the Supreme Court Act 1981 and by-pass the restrictions imposed by Parliament.

2.8 Following the Report on the Arbitration Bill of the Departmental Advisory Committee on Arbitration Law[21] a power to award compound interest was conferred on arbitrators by section 49 of the Arbitration Act 1996.[22] One of the main questions for consideration in this paper is whether this power should be extended to the courts.

THE CURRENT POSITION

Interest on debts

2.9 Interest on a debt is available:

(a) under a contract or trade usage (simple or compound);

(b) as special damages (simple or compound);

[16] Para 85, in relation to statutory debt interest; compound interest was not discussed in relation to discretionary interest on damages.

[17] Hansard (HL) 14 May 1982, vol 430 cols 429 to 432.

[18] [1985] 1 AC 104.

[19] [1893] AC 429 (HL).

[20] [1996] 1 AC 669.

[21] Published February 1996.

[22] Paras 2.43 to 2.45 below.

(c) under section 35A of the Supreme Court Act 1981 (simple only); or

(d) as of right under certain statutes (simple only).

Contract or trade usage

2.10 At common law there can be interest, simple or compound, on a debt, but only if the contract under which the debt arises, or the usage of the trade, so provides.[23]

2.11 It was held in *ex parte Bevan*[24] that there could not be an agreement in advance for compound interest. At most, where an agreement provides for a fixed time of payment and this time arrives, the creditor may forbear to press for payment on condition that the accrued interest is added to the capital: in effect, the debt is replaced by a new advance. One reason for the prohibition was that a necessary effect of compound interest, if continued for long enough, would be to make the effective rate of interest, as applied to the original amount of the debt, exceed the rate permitted by the usury laws. Now that the usury laws are repealed, there is no statute or rule of law forbidding prospective contractual provision for compound interest;[25] but it remains the case that a provision for interest does not imply compounding in the absence of an express term.

2.12 Many commercial enterprises, including the issuers of store cards and credit cards, have a practice of rendering statements of account at regular intervals, and of charging interest on the balance shown in these statements once it has been outstanding for 30 days. As this interest will itself appear in the following statement of account, the effect is that the interest is compound. While the compounding effect may not be expressly stated in the company's terms and conditions, it is a necessary consequence of the charging of interest on periodic balances, which is so stated. This is therefore an instance of contractual compound interest. Another example is the clause in construction contracts providing for reimbursement of "direct loss/expense", which has been held to justify the reimbursement of compound interest paid or foregone, though not the charging of compound interest as such.[26]

2.13 The same principle nowadays covers the practice of banks, which generally expressly provide in their terms and conditions for interest on balances existing from time to time, both on loans to customers and on credit balances.[27] Even without such an express term, it is an established custom that any interest owed to and by banks is treated in this way.[28] Another case in which compound interest is presumed as a matter of custom without the need for an express term is when two

[23] *London, Chatham and Dover Railway Co v South Eastern Railway Co* [1893] AC 429: see para 2.3 above.

[24] (1803) 9 Ves 223, 32 ER 588. See also *Fergusson v Fyffe* (1840-1) 8 Cl & Fin 121, 8 ER 49.

[25] Though extortionate credit bargains can be re-opened under the Consumer Credit Act 1974, s 137.

[26] See para 2.17 below.

[27] *Kitchen v HSBC Bank Plc* [2000] Lloyd's Rep Bank 173.

[28] *National Bank of Greece SA v Pinios Shipping Co. (No. 1)* [1990] 1 AC 637.

merchants periodically strike balances for their mutual transactions.[29] These were both originally justified by the presumption of periodic replacement by a new advance, as in *ex parte Bevan*;[30] but it is more natural to regard them as instances of compound interest due by commercial custom.

2.14 Another trade usage of long standing is that simple interest is due for delay in payment of a negotiable instrument with a fixed payment date.[31] This interest could depending on the circumstances be due either as a debt under the contract constituted by the instrument[32] or as damages for breach of that contract,[33] and the law is now codified in the Bills of Exchange Act 1882. A bill of exchange may itself provide for the payment of interest, and if no rate is specified the ordinary commercial rate, as described later in this paragraph, is understood. Whether or not interest is provided for by the bill itself, damages for a dishonoured bill include interest from the date of maturity or presentation;[34] though this may be withheld if justice requires.[35] Both the commercial rate for the purposes of contractual interest and interest as damages for dishonouring a bill are set somewhat above base rate: the court's special investment rate may be used.[36] Both types of interest are simple; but where a debt secured by an interest-bearing negotiable instrument is allowed to remain outstanding for a considerable period, the creditor will normally insist on the instrument being periodically cancelled and replaced by a fresh instrument for an amount including the accrued interest to date: this process has the same effect as if compound interest were charged.

Interest as damages

2.15 The claim in *London, Chatham and Dover Railway Co v South Eastern Railway Co*[37] was for interest as damages for late payment of a debt; and the purport of the decision was that such damage cannot be presumed from the bare fact of the delay in payment.[38] That does not preclude damages for late payment of a debt in principle, where the claimant has incurred out of pocket expenses as a result of the delay, and the defendant had actual knowledge of the need for those expenses. In other words there can be special damages under the second limb of the rule in

[29] *Deutsche Bank v Banque des Marchands de Moscou* (1949) 4 LDB 293.

[30] Para 2.11 above.

[31] *Farquhar v Morris* (1797) 7 Term Rep 124, 101 ER 889.

[32] *Herries v Jamieson* (1794) 5 Term Rep 553, 101 ER 310.

[33] *Dickenson v Harrison* (1817) 4 Price 282, 146 ER 465. See also the cases listed in footnote 12.

[34] Bills of Exchange Act 1882, s 57(1)(b).

[35] *Ibid*, s 57(3).

[36] *Practice Note (Claims for Interest)* [1983] 1 WLR 377. (The Practice Note speaks of the "short term investment account", which is now superseded: see footnote 95.) For the special investment rate, see para 2.47 below. For other instances of rates set by reference to bank base rates, see para 2.49(1) below.

[37] [1893] AC 429.

[38] Except in the negotiable instrument category of case: para 2.14 above, and cases in footnote 12.

Hadley v Baxendale.[39] It was held in *Wadsworth v Lydall*[40] that, provided that the conditions for special damages are met, such damages can include interest payments made by the claimant: for example interest for late completion of a purchase, or on a loan.[41] The case concerned simple interest, but the principle would extend to compound interest if this was what the claimant actually (and foreseeably, within the second limb of the rule) had to pay. It would be theoretically possible to extend the decision to the converse case in which the claimant, by reason of the delay, missed an opportunity for profit which the defendant knew would otherwise have been taken; but no such extension has as yet been made. *Wadsworth v Lydall* thus allows the recovery of damages reflecting interest paid by the claimant, rather than the award of interest as such on any sum payable by the defendant, and is confined to cases of late payment of debts. The principle remains that the common law could award interest *as* damages, but not interest *on* damages.

2.16 The question arises of whether the decision is likely to be extended judicially to cases within the first limb of the rule in *Hadley v Baxendale*, so as to allow interest in the form of general damages. It could be argued that every case of a debt unpaid or paid late necessarily involves a loss, either in the form of interest incurred or of investment opportunity foregone; but an extension on these lines is unlikely, as it would mean the complete reversal of the *London, Chatham and Dover Railway Co* decision. More realistically, damages could be allowed in cases of a specific interest expense where the defendant had no actual knowledge of the need for a loan but it is in the contemplation of a reasonable person that the claimant operates on credit, for example because the claimant runs a business. In England and Wales, however, the decision in *Wadsworth v Lydall* has not been extended in this way.[42] Thus, the award of damages in respect of interest paid seems still to be confined to the second limb of the rule in *Hadley v Baxendale*.

2.17 The one apparent exception to this is in the case of construction contracts incorporating the Joint Contracts Tribunal Standard Forms 1963, which provide for the reimbursement of "direct loss and/or expense". It has been held[43] that this is apt to include interest, either incurred or foregone, and that it is sufficient if the conditions in the first limb of the rule in *Hadley v Baxendale* are satisfied. The construction cases, like *Wadsworth v Lydall*, concerned compensation for interest rather than interest on compensation; but they specifically allowed compound interest given that this was what the plaintiff had had to pay. These decisions strictly speaking address the interpretation of the Joint Contracts Tribunal Standard Forms 1963 rather than the general law of unpaid debts, and concern a

[39] (1854) 9 Exch 341, 156 ER 145. The first limb refers to losses that are foreseeable by anyone given the nature of the breach, while the second limb refers to those losses that are only foreseeable given specific information known to the contract-breaker.

[40] [1981] 1 WLR 598.

[41] Earlier cases on the possibility of special damages to reimburse interest payments are *de Bernales v Wood* (1812) 3 Camp 259, 170 ER 1375; *Farquhar v Farley* (1817) 7 Taunt 592, 129 ER 236; *Petre v Duncombe* (1851) 2 L M & P 116.

[42] Australian and New Zealand courts have applied the decision more widely, see para 3.2.

[43] *FG Minter Ltd v Welsh Health Technical Services Organisation* (1980) 13 BLR 7; (Scotland) *Ogilvie Builders Ltd v Glasgow City District Council* (1994) 68 BLR 122.

contractual provision for reimbursement of expense rather than a liability to damages; but the analogy to damages was close enough for *Hadley v Baxendale* to be cited. This group of cases is the nearest approach that English law has made to allowing interest as general damages; but this is only in the sense that the requirement of specific knowledge by the defendant is relaxed, and not in the sense of a general allowance for likely interest loss without proof of an identifiable outlay or loss of profit.

Interest under the Supreme Court Act 1981

2.18 Section 35A of the Supreme Court Act 1981 confers a power to award simple interest in a judgment for a debt or damages: interest on damages is considered in more detail below.[44] (Section 69 of the County Courts Act 1984 is in virtually identical terms: in what follows, everything said about the power under section 35A of the Supreme Court Act applies equally to the power under the County Courts Act.) The section also provides for interest on a debt that has been wholly paid after the institution of the action otherwise than under a judgment.[45] Since there is then no judgment for the principal sum, the relevant subsection reads "the defendant *shall* be liable to pay the plaintiff" rather than "the judgment may include", but leaves it to the court to determine whether the interest is to run on the whole or part of the sum, and the rate at which and the period for which it is to run. There is no power to award interest on a sum paid in full before the institution of the action, to represent the delay in payment from the time provided in the contract.

2.19 It was made clear in the *Westdeutsche Landesbank* case that the power under section 35A is exclusive. That is to say, while there is an equitable power to require payment of interest on money found to be due on the taking of an account in equity, or otherwise in connection with an equitable remedy,[46] this power will not be used in support of a judgment for an ordinary debt, as the statutory power exists for this purpose and should not be duplicated or by-passed. Thus the equitable power cannot be used as a means of awarding compound interest, except in the traditional cases of fraud and profit made from a fiduciary position.[47]

Interest under other statutes

2.20 There are various particular situations, such as unpaid tax, where statutory interest is payable as of right. In the case of tax, interest normally runs from the time when the tax became due and payable, though in certain cases of late assessment or postponement on appeal, the interest can be back-dated to a time when the tax existed as a liability but was not yet fully quantified.[48] Where statutory interest exists, only simple interest is available and the power in section 35A of the

[44] Para 2.32 below.

[45] Supreme Court Act 1981, s 35A(3).

[46] *President of India v La Pintada Compania Navigacion SA* [1985] 1 AC 104, 116; and see para 2.41 below.

[47] Paras 2.38 and 2.41 below.

[48] Taxes Management Act 1970, s 86.

Supreme Court Act 1981 is excluded.[49] One possible reason for the restriction to simple interest is that the authorities to whom the money is owed generally have special statutory powers to enforce payment, so that it is not expected that these debts will remain outstanding for a considerable period.

2.21 There are a number of instances where interest is payable on sums due in connection with compulsory purchase or land compensation.[50] Examples are:

(a) compensation for compulsory purchase: interest is payable under section 11 of the Compulsory Purchase Act 1965;

(b) compensation where a general vesting declaration is used: interest is payable under section 10 of the Compulsory Purchase (Vesting Declarations) Act 1981;

(c) advance payment under section 52 of the Land Compensation Act 1973: interest is payable under section 52A of that Act;

(d) compensation for injurious affection under section 68 of the Land Clauses Consolidation Act 1845 or section 10 of the Compulsory Purchase Act 1965: interest is payable under section 63 of the Land Compensation Act 1973;

(e) compensation under various planning statutes (for example, the Ancient Monuments and Archaeological Areas Act 1979; Land Drainage Act 1991; Highways Act 1980; Building Act 1984; Water Industry Act 1991; Town and Country Planning Act 1990; Planning (Listed Buildings and Conservation Areas) Act 1990): interest is payable under section 80 of the Planning and Compensation Act 1991.

2.22 In all these cases, the interest is simple interest at a rate prescribed from time to time under section 32 of the Land Compensation Act 1961. In a case where the compensation is awarded by the Lands Tribunal there is an apparent conflict between these provisions and rule 32(b) of the Lands Tribunal Rules 1996,[51] which provides that section 47 of the Arbitration Act 1996 (discretion to award simple or compound interest) applies to proceedings before the Tribunal. However this is stated to be "subject to any enactment that prescribes a rate of interest", and it seems therefore that, in cases within section 32, the Tribunal is bound by the prescribed rate.[52] If (which is doubtful) there are still compensation claims outside

[49] Supreme Court Act 1981, s 35A(4).

[50] Law Commission Consultative Report (Consultation Paper No 165) "Towards a Compulsory Purchase Code: (1) Compensation" paras 8.33 to 8.39. For the possibilities of reform, see para 4.58 below.

[51] SI 1996 No 1022; rule 32 was substituted by rule 9 of the Lands Tribunal (Amendment) Rules 1997 (SI 1997 No 1965).

[52] *Aslam v South Bedfordshire DC* [2001] RVR 65.

the scope of section 32 of the Land Compensation Act 1961, the Arbitration Act discretion will apply.[53]

2.23 Another example of statutory interest is section 42 of the Partnership Act 1890, which provides:

> Where any member of a firm has died or otherwise ceased to be a partner, and the surviving or continuing partners carry on the business of the firm with its capital or assets without any final settlement of accounts as between the firm and the outgoing partner or his estate, then, in the absence of any agreement to the contrary, the outgoing partner or his estate is entitled at the option of himself or his representatives to such share of the profits made since the dissolution as the Court may find to be attributable to the use of his share of the partnership assets, or to interest at the rate of five per cent. per annum on the amount of his share of the partnership assets.[54]

The provision is very similar to the equitable remedies for misappropriated trust assets.[55]

2.24 The Late Payment of Commercial Debts (Interest) Act 1998 was introduced as an attempt to tackle the problem of late payment of commercial debts, and represents the implementation in a limited context of the proposal for statutory interest in the Law Commission's 1978 report.[56] Late payment causes particular difficulties for small businesses.[57] The Act introduces a statutory right to claim interest on unpaid commercial debts.

2.25 Section 1(1) of the Act provides that:

> It is an implied term in a contract to which this Act applies that any qualifying debt created by the contract carries simple interest subject to and in accordance with this Part.

The rate of simple interest available under the Act is meant to be a commercial but not a penal rate of interest.[58] In its Green Paper, the Government recommended an interest rate of 4 per cent above the base rate as a rate that would both compensate the creditor and eliminate the attraction of late payment as a cheap debt. This rate was chosen as the average rate of interest on bank loans to small businesses.[59] The Government favoured simple rather than compound interest because they believed that simple interest would be significantly easier to calculate and that the difference between compound and simple interest would be immaterial in most

[53] *Aslam*, in relation to the previous discretion under the Arbitration Act 1950.

[54] For the Law Commission's proposals for the reform of this section, see para 4.59 below.

[55] Para 2.39 below.

[56] Para 2.5 above.

[57] House of Commons Research Paper 98/42 (2 April 1998) p 7.

[58] House of Commons Research Paper 98/42, p 19.

[59] Green Paper, *Improving the Payment Culture: A Statutory Right to Claim Interest on Late Payment of Commercial Debt*, URN 97/781, para 7.3.

cases.[60] Following consultation, the Government adopted the suggestion of the Bank of England and increased the proposed interest rate to 8 per cent above the base rate, representing the rate of overdraft interest available to the smallest and most vulnerable businesses.[61] This rate was introduced by the Late Payment of Commercial Debts (Rate of Interest) (No 2) Order 1998.[62]

2.26 The Act has been brought into force in stages by a series of four commencement orders.[63] For contracts made before 7 August 2002 it applies between a small business supplier[64] and a purchaser who is:

(a) a large business purchaser;[65]

(b) a UK public authority specified in either of the first two commencement orders;

(c) a person or body named in the Schedule to the third commencement order;[66] or a small business purchaser, as defined.[67]

For contracts made after 7 August 2002, the Act has been extended to meet the requirements of a European Union Directive.[68]

2.27 Directive 2000/35/EC of the European Parliament and of the Council of 29 June 2000 on combating late payment in commercial transactions was adopted following Resolutions of the European Parliament[69] and a report by the Commission on late payments in commercial transactions.[70] The reasoning was very similar to that behind the Late Payment of Commercial Debts (Interest) Act 1998, though that Act seems to have been passed independently of the European Union's concerns. Certain aspects of the Late Payment of Commercial Debts

[60] *Ibid*, para 7.4.2

[61] DTI press notice, *Barbara Roche Announces Legislation on Late Payment of Commercial Debt*, 11 December 1997 P/97/830; URN 97/965, December 1997, p 13; House of Commons Research Paper 98/42, page 19; *Hansard* (HC) 5 May 1998, cols 597-8, Barbara Roche.

[62] SI 1998 No 2765.

[63] SI 1998 No 2479; SI 1999 No 1816; SI 2000 No 2225; SI 2000 No 2740.

[64] Defined in Late Payment of Commercial Debts (Interest) Act 1998 (Commencement No 1) Order 1998 (SI 1998 No 2479), art 2(1)(c), and in the corresponding provisions of the other commencement orders.

[65] Defined SI 1998 No 2479, art 2(1)(a).

[66] The Comptroller and Auditor General for Northern Ireland; the Metropolitan Police Authority; the London Fire and Emergency Planning Authority.

[67] Defined in Late Payment of Commercial Debts (Interest) Act 1998 (Commencement No 4) Order 2000 (SI 2000 No 2740), art 2(1)(b).

[68] See para 2.27 below.

[69] e.g. Parliament Resolution on the Commission Recommendation on payment periods in commercial transactions OJ C 211, 22.7.1996, p 43.

[70] OJ C 216, 17.7.1997, p 10.

(Interest) Act 1998 have been revised to meet the requirements of the Directive.[71] For contracts made after 7 August 2002, the Late Payment of Commercial Debts (Interest) Act 1998 (Commencement No. 5) Order 2002[72] extends the provisions of the Late Payment of Commercial Debts (Interest) Act to enable businesses of all sizes and the public sector to claim interest on commercial debts.

2.28 The Late Payment of Commercial Debts Regulations 2002[73] insert a new section 5A into the 1998 Act that entitles the supplier to a fixed sum of compensation in addition to the statutory interest once such interest begins to run on a qualifying debt.[74] The amount of compensation is fixed on a scale under the regulations by reference to the size of the debt.[75]

2.29 Article 3 of the Directive sets out the rules governing the imposition of interest in cases of late payment. Interest is payable "from the day following the date or the end of the period for payment fixed in the contract". Where no date or period for payment is fixed in the contract, Article 3(1)(b) makes interest run from 30 days following receipt of the invoice or receipt or acceptance of the goods, depending on the circumstances. Section 4 of the Late Payment of Commercial Debts (Interest) Act 1998 makes the same provision and therefore no amendment has been made to this aspect of the Act.

2.30 The rate of interest for late payment is set out in Article 3(1)(d) as:

> the sum of the interest rate applied by the European Central Bank to its most recent main refinancing operation carried out before the first calendar day of the half-year in question ... plus at least seven percentage points (the 'margin') unless otherwise specified in the contract.[76]

This rate applies for countries participating in the third stage of European economic and monetary union. For countries not participating in this process, including the UK, "the reference rate referred to above shall be the equivalent rate set by its national central bank".[77] Therefore the minimum rate applicable in the UK would be the Bank of England official dealing rate plus 7 per cent. In fact the

[71] For a discussion of the impact of the Directive see the Department of Trade and Industry Regulatory Impact Assessment *Transposition into UK Law of EC Directive 2000/35/EC on combating late payment in commercial transactions* available online at www.sbs.gov.uk.

[72] SI 2002 No 1673

[73] SI 2002 No 1674

[74] SI 2002 No 1674 reg 2(4)

[75] SI 2002 No 1674 reg 2(4)

[76] Directive 2000/35/EC, Art 3(1)(d).

[77] *Ibid.*

Government has decided to exceed the minimum requirement and has maintained the rate at 8 per cent above the Bank of England official dealing rate.[78]

2.31 Neither the Directive nor any of the preparatory resolutions and reports mentions the possibility of compound interest. The Directive recognises that a different rate of interest for late payment may be specified in the contract.[79] This provides an opportunity for the parties to agree for compound interest to be charged on late payments. It is also open to member States to provide that in certain circumstances the time for payment will be increased from 30 to 60 days but that a higher rate of interest will be imposed.[80] This could conceivably be done by imposing compound interest, but the straightforward meaning of the Directive would be simple interest at a higher rate. As the rates specified in the Directive take the form of a minimum, there is nothing to prevent member States from going further than the Directive requires, for example by making interest compound.

Interest on damages

2.32 At common law there is never interest on damages; nor would there appear to be a power in equity to award interest, simple or compound, on common law damages.[81] There is discretion to award simple interest under section 35A of the Supreme Court Act 1981 together with the damages themselves. In the case of damages for death or personal injuries in excess of £200, the court must award interest unless there are special reasons to the contrary.[82]

2.33 There are some aspects of practice special to damages for personal injury. Interest on damages representing loss of earnings or continuing medical expense is often awarded at 4 per cent to reflect the fact that they accrue over a period.[83] Interest on damages for pain and suffering is generally awarded at 2 per cent to reflect the fact that the damages are assessed as at the date of the award and therefore already allow for the effects of inflation.[84] The latter type of damages is only computed from the date proceedings are brought. This rule, which appears arbitrary, may be defended on the pragmatic ground that it to some extent counter-balances the

[78] The Late Payment of Commercial Debts (Rate of Interest) (No. 2) Order 1998 is replaced under Article 2 of The Late Payment of Commercial Debts (Rate of Interest) (No. 3) Order 2002.[78] Article 4 of the 2002 Order sets the statutory interest rate at 8 per cent over the Bank of England official dealing rate. The rates in force on the first calendar day of the half-year will apply for the following six months.

[79] Directive 2000/35/EC, Art 3(1)(d).

[80] *Ibid.*

[81] There is no case which specifically states this in relation to damages; but the reasoning in *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] 1 AC 669, which reaches the same conclusion in relation to debts, would be equally applicable in damages cases.

[82] Supreme Court Act 1981, s 35A(2).

[83] See para 2.49(2) below, and the Law Commission's Report on Damages for Personal Injury: Medical, Nursing and Other Expenses; Collateral Benefits (Law Com No 262) paras 7.5 to 7.16.

[84] See para 2.49(3) below, and the Law Commission's Report on Damages for Personal Injury: Non-Pecuniary Loss (Law Com No 257) paras 2.29 to 2.58.

effect of including damages for future suffering in the sum on which interest is awarded.[85]

2.34 In the Admiralty jurisdiction there has always been simple interest on damages for running down,[86] and more recently, in *The Aldora*,[87] this was held to extend to salvage and, by implication, other money awards made within that jurisdiction. Historically the Admiralty jurisdiction was confined to collisions, salvage, seamen's wages, bottomry bonds (that is, certain loans secured on ships) and the like, all of which are secured by maritime lien. The Admiralty jurisdiction has since been greatly extended,[88] but no maritime liens were created for the claims within the extensions. The question was raised whether the power to award interest extends to them: in *President of India v La Pintada Compania Navigacion SA*[89] Lord Brandon said, obiter, that it does. He also stated, contrary to an understanding previously prevailing in some quarters,[90] that there had never been a practice of awarding compound interest on damages in Admiralty cases.[91] Similarly, the power cannot be used to award interest on money paid before the commencement of proceedings.[92]

Interest in trust and other equity cases

2.35 Interest under the equitable jurisdiction is awarded under the inherent power of the court and not under section 35A of the Supreme Court Act 1981. Money claims against trustees fall into two distinct categories. Some are simple claims for compensation, based on the loss suffered by the beneficiary because of a breach of duty by the trustee; others have a proprietary character, and relate to money in the hands of the trustee to which the beneficiary is entitled. The two categories are treated differently for purposes of interest;[93] and within the second category there is a further distinction based on the trustee's use of the money.

2.36 A claim against a trustee based on negligence, such as the trustee's failure to claim an amount due to the trust, or to invest an amount, is a compensation claim. In the case of entire failure to claim an amount, the trustee will be ordered to make good the loss by paying the amount together with interest. In the case of culpable delay in claiming an amount, or of failure to invest an amount, subject to any specific direction as to investment in the trust the compensation itself takes the

[85] *Ibid* para 2.45.

[86] *The Dundee* (1827) 2 Hagg Adm 137, 166 ER 194.

[87] [1975] QB 748.

[88] The extensions are consolidated in Supreme Court Act 1981, s 20.

[89] [1985] 1 AC 104, 121.

[90] E.g. *Tehno-Impex v Gebr van Weelde Scheepvaartkantoor BV* [1981] QB 648; *Polish Steam Ship Co v Atlantic Maritime Co* [1983] QB 687 (decision at first instance).

[91] [1985] AC 104, 119H, 120G-121B. See also *Polish Steam Ship Co v Atlantic Maritime Co* [1985] QB 41 (CA), which lays down that where a limitation fund is paid into court and interest accrues on interest already in the fund, this is available as a source for the payment of such damages, but only to the extent of the limitation figure plus simple interest.

[92] [1985] AC 104, 119G, 120G-121B.

[93] Elliott, "Rethinking Interest on Withheld and Misapplied Trust Money" [2001] Conv 313, distinguishes between compensatory interest and disgorgement interest.

form of interest on the amount which should have been claimed or invested. Traditionally such interest was awarded at 4 per cent, on the analogy of the then rate of statutory interest on judgment debts and on legacies.[94] At present the rate is at the discretion of the court: the courts' special investment rate is often applied.[95]

2.37 In cases of failure to claim or invest capital, interest is only compounded where the terms of the trust require profits to be accumulated, for example during a minority.[96] This may be derived from the former rule of practice that equity only awarded interest on amounts which form, or should have formed, part of the capital of the trust, and not (for example) on arrears of income which should have been paid to the beneficiary.[97]

2.38 Where there is a breach of trust going beyond negligence, and the trustee has in some way benefited, for example where the money has been left with a firm in which he or she is a partner, the claim acquires a proprietary character. In such cases interest is awarded to represent the income which the trustee is presumed to have gained by investing that amount. Historically this was set at 5 per cent;[98] now it is at the discretion of the court, but may be set by reference to a current economic indicator, for example at 1 per cent above base rate, or 1 per cent above LIBOR (London Inter-Bank Offered Rate).[99]

2.39 This interest is only compounded where the trustee has applied the money in a trade: such compound interest represents the profits the trustee is presumed to have made.[100] If it is shown that the profits made were actually greater, the trustee is accountable for these.[101] In other words, the beneficiary has the right to elect between compound interest and the money found due on an account to assess the actual profits made.[102] In all cases, the interest awarded is designed to represent the interest that the trustee received, or ought to have received, or may be presumed to have received, and is not a punitive measure.[103] Such interest can be awarded even

[94] *Re Davy* [1908] 1 Ch 61.

[95] *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515. This referred to the "short-term investment account established under section 6 of the Administration of Justice Act 1965", which no longer exists. For the special investment account, which replaces it, see paras 2.47 and 2.49 below.

[96] *Knott v Cottee* (1852) 16 Beav 77, 51 ER 705; *Re Emmet's Estate* (1881) 17 Ch D 142; *Re Barclay* [1899] 1 Ch 674.

[97] *Blogg v Johnson* (1867) LR 2 Ch 225: and see the last part of para 2.40 below.

[98] *Gordon v Gonda* [1955] 1 WLR 885.

[99] *Wallersteiner v Moir (No 2)* [1975] QB 373.

[100] *Jones v Foxall* (1852) 15 Beav 388, 51 ER 588; *Burdick v Garrick* (1870) 5 Ch App 233; *Belmont Finance Corporation v Williams Furniture Ltd (No 2)* [1980] 1 All ER 393, 419; *O'Sullivan v Management Agency and Music Ltd* [1985] QB 428.

[101] *Re Jenkins' and Randalls' Contract* [1903] 2 Ch 362; *Wright v Morgan* [1926] AC 788, 799.

[102] *Vyse v Foster* (1872) 8 Ch App 309, 334; (1874) LR 7 HL 318. This election exists unless the amount involved is too small to justify the trouble and expense of taking an account, as in *ex parte Strutt* (1788) 1 Cox Eq Cas 439, 29 ER 1239, where the fund was £500.

[103] *AG v Alford* (1855) 4 De G M & G 843, 43 ER 737.

though the principal was wholly paid before the commencement of the proceedings.[104]

2.40 Interest on legacies follows the same principles as interest on amounts from trusts, in that interest is only compounded where the will contains a direction to accumulate or the executor has made a profit from breach of his or her fiduciary duty.[105] In most cases interest will not begin to run until the end of the year following the testator's death, which is the period in which the executor is expected to have gathered in the assets and paid the debts.[106] Interest on a pecuniary legacy may run from the date of death if the legacy is secured on realty,[107] or is directed to be paid immediately after the death, or is in settlement of a debt,[108] or in certain cases where the amount is required for the maintenance of a child. There was once a rule that interest would not be awarded on arrears of an annuity payable under a will.[109] This has since been attenuated into a rule that such interest will not be awarded unless the personal representatives are in some way to blame for the delay in payment;[110] and we are informed that today it is not possible to lay down any certain rule on the matter.

2.41 Outside the trust field, equity will order interest against an agent or receiver who fails to render an account.[111] A constructive trust found to exist because of fraud, or because of profits made from a fiduciary position (whether or not by an actual trustee), may be treated in the same way as an express trust if it is possible to identify the money and ascertain its investment history. Often however a constructive trust differs from an express trust in that there is no trust fund which preserves its identity throughout a history of investment. The existence of such a fund must then be supposed as a kind of fiction, as in the equitable remedy of tracing. In such cases, compound interest will be awarded, on the analogy of the earnings that the putative trust fund ought to have made.[112] Traditionally, in these cases as in the express trust cases, compound interest was only awarded when the fiduciary had a trade in which the money could be invested. It has been argued[113] that since the *Westdeutsche* case this condition is no longer essential;[114] but its

[104] *Mathew v T M Sutton Ltd* [1994] 1 WLR 1455.

[105] Williams, Mortimer and Sunnucks, *Executors, Administrators and Probate* (18th/6th edition, London 2000) ch 76 and authorities there cited.

[106] *Maxwell v Wettenhall* (1722) 2 P Wms 26, 24 ER 628, 2 Wils 27; *Turner v Buck* (1874) LR 18 Eq 301.

[107] *Re Waters, Waters v Boxer* (1889) 42 Ch D 517.

[108] *Shirt v Westby* (1808) 16 Ves 393, 33 ER 1033.

[109] *Torre v Brown* (1855) 5 HL Cas 555; *Wheatley v Davies* (1876) 35 LT 307; *Re Hiscoe, Hiscoe v Waite* [1902] WN 49, 71 LJ Ch 347.

[110] *Re Salvin, Worseley v Marshall* [1912] 1 Ch 332; *Re Berkeley* [1968] Ch 744.

[111] *Earl of Harwicke v Vernon* (1808) 14 Ves 504, 33 ER 614; *Pearse v Green* (1819) 1 Jac & W 135, 37 ER 327.

[112] *Wallersteiner v Moir (No 2)* [1975] QB 373.

[113] Elliott, "Rethinking Interest on Withheld and Misapplied Trust Money" [2001] Conv 313, 333, citing *Kuwait Oil Tanker Company SAK v Al Bader* (unreported 21 December 1998), varied [2000] 2 All ER (Comm) 271.

[114] [1996] 1 AC 669, 702 *per* Lord Browne-Wilkinson.

existence is still assumed in *Clef Aquitaine SARL v Laporte Materials (Barrow) Ltd.*[115] This kind of interest presents no analogy to compensatory interest on debt or damages: it depends on the proprietary character of the claim, and represents the deemed profit of the defendant rather than the deemed loss of the claimant.

Interest in restitution cases

2.42 For the purposes of interest in restitution cases, as in the law of restitution generally, the question has been litigated whether restitutionary liabilities are more closely analogous to contractual debts or to resulting trusts. In the case of actions for money had and received, it has been held that, notwithstanding the analogy to resulting trusts, ordinary debt principles apply.[116] At common law, there was no interest on a claim for money had and received.[117] Accordingly, in the absence of fraud or profits made from a fiduciary position, the only remedy is simple interest under section 35A of the Supreme Court Act 1981: compound interest is not available. This only applies to the action for money had and received. It is still arguable that there are other categories of unjust enrichment in which the claimant's right should be treated as proprietary in nature rather than as a debt, so that any interest should represent the presumed gain of the defendant rather than the loss of the claimant. This would justify the possibility of compound interest; but we have seen no instance of this outside the fiduciary and constructive trust class of case mentioned in the previous paragraph.

Arbitration

2.43 Section 49 of the Arbitration Act 1996 states:

> **Interest**
>
> **49.**— (1) The parties are free to agree on the powers of the tribunal as regards the award of interest.
>
> (2) Unless otherwise agreed by the parties the following provisions apply.
>
> (3) The tribunal may award simple or compound interest from such dates, at such rates and with such rests as it considers meets the justice of the case—
>
> (a) on the whole or part of any amount awarded by the tribunal, in respect of any period up to the date of the award;
>
> (b) on the whole or part of any amount claimed in the arbitration and outstanding at the commencement of the arbitral proceedings but paid before the award was made, in respect of any period up to the date of payment.
>
> (4) The tribunal may award simple or compound interest from the date of the award (or any later date) until payment, at such rates and

[115] [2000] 3 All ER 493.

[116] *Kleinwort Benson Ltd v South Tyneside MBC* [1994] 4 All ER 972; *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] 1 AC 669.

[117] *Walker v Constable* (1798) 1 B & P 306, 307, 126 ER 919; *De Havilland v Bowerbank* (1807) 1 Camp 50, 170 ER 872; *Depcke v Munn* (1828) 3 Car & P 112, 172 ER 347; *Frühling v Schroeder* (1835) 2 Bing N C 77, 132 ER 31.

> with such rests as it considers meets the justice of the case, on the outstanding amount of any award (including any award of interest under subsection (3) and any award as to costs).
>
> (5) References in this section to an amount awarded by the tribunal include an amount payable in consequence of a declaratory award by the tribunal.
>
> (6) The above provisions do not affect any other power of the tribunal to award interest.

2.44 The Arbitration Act 1996 was in the main based on the UNCITRAL Model Law on International Commercial Arbitration (1995). Neither the Model Law nor the UNCITRAL Arbitration Rules make any mention of interest, though this is currently being considered by an UNCITRAL Working Group.[118] One reason for the introduction of the power to award compound interest was that it was felt that the absence of such a power encouraged respondents to delay the proceedings, since:

> the interest eventually payable is less than can be made by holding on to funds which should be paid over to the other party, who of course is losing out by a like amount.[119]

It appeared that the proposal to introduce this power was generally welcomed by those consulted.[120] Other countries, such as Ireland,[121] have incorporated similar powers into their statutes implementing the 1996 Model Law, and similar provisions are found in the rules of organisations providing international arbitration services.[122]

2.45 Arbitral tribunals thus have a power to award compound interest, both up to and after the date of their decisions, exceeding that of the courts. The difference in powers is widely regarded as anomalous. The extent to which the use of those powers differs is harder to determine. We have made some enquiries about the practice of arbitrators and received a variety of responses from which no clear pattern emerges. Compound interest is often awarded in banking and financial cases; but this may be because such interest is usually due as a matter of substantive law.[123] In large commercial and maritime cases, and in construction cases, compound interest is sometimes awarded. Again this is sometimes under the terms of the charterparty or other contract rather than under the power given by the Arbitration Act. In other cases many arbitrators regard it as their function to

[118] United Nations General Assembly paper, A/CN 9/WG II/WP.114.

[119] Para 236 of the Report on the Arbitration Bill of the Departmental Advisory Committee on Arbitration Law (published February 1996). The Report contains a detailed commentary on the reasons for introducing this power in the 1996 Act and on the results of consultation.

[120] *Ibid*, para 235.

[121] Arbitration (International Commercial) Act 1998, s 10(2).

[122] For example, World Intellectual Property Organization, Arbitration Rules art 60; London Court of International Arbitration, Arbitration Rules art 26.6; North American Free Trade Agreement art 1135(1)(a). The Arbitration Rules of the International Chamber of Commerce (1998) are silent on interest.

[123] See para 2.13 above.

replicate what a court would do and therefore do not award compound interest at all, while others again will award it occasionally as a punitive measure.

Money in court

2.46 The present practice is governed by Part 36 of the Civil Procedure Rules 1998. The defendant pays in a sum representing the debt or damages offered together with interest under section 35A of the Supreme Court Act 1981, calculated for the period from the arising of the cause of action to the last available day for accepting the payment. If no interest calculation is included, the amount paid in is taken to include interest to that date and the deemed principal reduced accordingly.[124] If the claimant refuses this offer and the matter goes to trial, a comparison is made between the amount paid in and the amount awarded by the court, inclusive of interest up to the last day for acceptance. If the amount awarded does not exceed the amount paid in, the claimant is not allowed costs incurred after the date of the payment in, as he or she should have accepted the offer constituted by that payment.[125]

2.47 When money is paid into court, the court pays the money into its account at the Bank of England. The court keeps an account in its books for each case in which there is a payment in; this may be either a basic account, for most cases,[126] or a special investment account, for children and patients.[127] Interest is credited to each account half-yearly, and forms part of the balance, so that each account earns compound interest like a bank account. The rates are set by an exchange of letters between the Lord Chancellor and the Treasury,[128] and are currently 5.25 per cent for the basic account and 7 per cent for the special investment account. After the conclusion of the case the interest earned in court is available to satisfy any award to the claimant (including the interest awarded under section 35A of the Supreme Court Act 1981); any excess left after this is repaid to the defendant.

2.48 Conversely, it is possible for a claimant to make an offer under Part 36, in the form of a proposed figure of damages for which the proceedings may be settled. If the defendant declines the offer, and the claimant is then awarded damages at trial, the same comparison is made as in the case of payments into court: namely whether the amount of the damages awarded, together with interest up to the last day for accepting the offer, exceeds the amount of the offer, which also includes interest to that date. If it does, a number of consequences follow: the court may (and normally should) award the claimant:

[124] CPR, r 36.22.

[125] CPR, r 36.20.

[126] Court Funds Rules 1987, r 28(1); SI 1987 No 821.

[127] Court Funds Rules 1987, r 28(1); SI 1987 No 821. A patient in this context is 'a person who by reason of mental disorder within the meaning of the Mental Health Act is incapable of managing and administering his own affairs'; CPR Part 21 and Practice Directions (PD21). These two accounts supersede the "short-term investment account" referred to in the cases.

[128] Administration of Justice Act 1982, s 38(7).

(a) costs on an indemnity basis, for all costs incurred from the last time at which the defendant could have accepted the offer;

(b) interest on those costs; and

(c) interest on the damages or other sum recovered, excluding any interest element in that sum.[129]

The interest on the sum recovered is separate from, and may be recovered in addition to, any interest awarded under any other power, such as under section 35A of the Supreme Court Act 1981; but the interest under the rule must be set in such a way that the total rate of interest does not exceed 10 per cent over base rate.[130]

Interest rates

2.49 Interest under section 35A of the Supreme Court Act 1981 may be either at a rate set by the court in the particular case or at a rate prescribed in rules of court; and there is specific power to link the prescribed rate to the rate under section 17 of the Judgments Act 1838.[131] This power has been exercised, but only in relation to default judgments.[132] In many cases the courts link their awards to the rate of interest under the Judgments Act.[133] This rate is fixed by statutory instrument and has been 8 per cent since 1 April 1993.[134] Alternatively awards may be linked to the special investment rate on money paid into court[135] (currently 7 per cent). Exceptions are as follows.

(1) In cases in the Commercial Court and Admiralty cases it is usual to award interest based on current economic indicators, such as 1 per cent over base rate,[136] or 1 per cent over LIBOR,[137] and such rates are occasionally awarded in cases of economic loss outside the Commercial Court.[138]

[129] CPR, r 36.21.

[130] CPR, r 36.21(6). See also *McPhilemy v Times Newspapers Ltd (No 2)* [2001] 4 All ER 861, 872.

[131] Supreme Court Act 1981, s 35A(5); see para 2.2 above.

[132] CPR, r 12.6(1).

[133] *Watts v Morrow* [1991] 1 WLR 1421.

[134] Judgment Debts (Rate of Interest) Order 1993 (SI 1993 No 564).

[135] *Harrison v Bloom Camillin (No. 2)* [2000] Lloyd's Rep PN 404 (contract cases); *Jefford v Gee* [1970] 2 QB 130 (personal injuries, apart from the award for pain and suffering). For the special investment account, see para 2.47 above.

[136] *Polish Steam Ship Co v Atlantic Maritime Co (The Garden City)* [1985] QB 41.

[137] *Dubai Aluminium* [1999] 1 Lloyd's Rep 415, 465.

[138] *Metal Box Co Ltd v Currys Ltd* [1988] 1 WLR 175.

(2) Damages for loss of earnings or loss of dependency over a period typically attract interest on the total earnings lost, at half the normal interest rate (typically 4 per cent), so as to reflect the gradual nature of the loss.[139]

(3) The pain and suffering element of personal injury damages usually attracts interest of only 2 per cent, starting from the date of issue of proceedings,[140] to reflect the fact that the award is made by reference to the value of money prevailing at the time of the award rather than at the time of the incident.

2.50 The authority for the rate of 2 per cent is found in *Birkett v Hayes*[141] and *Wright v British Railways Board.*[142] In England and Wales it is confined to personal injury damages, though it would be possible in principle, and is customary in some countries,[143] to base awards for damage to property on the present value of property and give a discounted rate of interest, as opposed to the historic value and full interest. The figure of 2 per cent was arrived at in two ways. At the time, the difference between the current rate of inflation and current interest rates was 4 per cent; once tax was allowed for, that gave a figure of between 2 per cent and 3 per cent. Secondly, 2 per cent was the usual yield on index-linked stocks, such as those made available to pension funds.[144] In a previous report we considered whether there should be a change to this rate by legislation.[145]

2.51 The rules about interest in trust and constructive trust cases have been described above in some detail.[146] Briefly, interest may be awarded at any of the customary rates: the court's special investment rate, a rate set by reference to an economic indicator such as bank rate or LIBOR, or sometimes the rate for judgment debts.

2.52 Statutory interest payable as of right has its own special rates in each case. The rate for interest on unpaid tax is prescribed by regulations under section 178 of the Finance Act 1989,[147] and is set at 2.5 per cent above the average of the base lending rates of seven leading banks named in the regulations. Similarly, a refund of non-domestic rates resulting from an alteration of the rating lists carries interest at 1 per cent less than the median of the base lending rates of the seven largest banking institutions for the time being.[148] The rate in compulsory purchase and

[139] *Jefford v Gee*, above; Law Commission's Report on Damages for Personal Injury: Medical, Nursing and Other Expenses; Collateral Benefits (Law Com No 262) paras 7.5 to 7.16.

[140] See para 2.33, and the Law Commission's Report on Damages for Personal Injury: Non-Pecuniary Loss (Law Com No 277) paras 2.29 to 2.58.

[141] [1982] 1 WLR 816.

[142] [1983] 2 AC 773.

[143] See para 3.8 below.

[144] The British Columbia Law Reform Commission (Report on the Court Order Interest Act, 1987 LRC 90, page 64 note 18) interprets the figure of 2% as being half the difference between the rates, on the reasoning that pain and suffering occur continuously over the period for which interest is paid; but this was never the justification for the English practice, whether or not it was used in New South Wales, to which the report also refers.

[145] Law Commission's Report on Damages for Personal Injury: Non-Pecuniary Loss (Law Com No 277) para 2.58; para 4.41(3) below.

[146] Paras 2.35 to 2.41 above.

[147] Taxes (Interest Rate) Regulations 1989 (SI 1989 No 1297).

[148] Non-Domestic Rating (Payment of Interest) Regulations 1990 (SI 1990 No 1904).

land compensation cases[149] is 0.5 per cent below the rate quoted by the reference banks for the time being.[150] The rate of interest under the Late Payment of Commercial Debts (Interest) Act 1998 is 8 per cent above base rate.[151]

2.53 Appendix A to this Consultation Paper contains graphs entitled "Court interest rates" and "Economic rates". These show the interest rates for judgment debts and on money paid into court as compared with bank base rate, 3-month LIBOR and rates of inflation over the last twenty years. From this it will appear that the normal rates of interest on debts and damages have generally exceeded the commercial rates as shown in the economic indicators. This to some extent compensates for the unavailability of compound interest; but it can lead to anomalous results in trust cases,[152] as compared with the nineteenth-century jurisprudence which took it for granted that the rate for proprietary claims would always exceed that for the simple compensation claims.

Summary

2.54 Compound interest is only awarded in the following cases:

(a) where the contract, or the usage of a trade, provides for compound interest;

(b) in trust and constructive trust cases, where the claim has a proprietary flavour and the defendant has applied the money in trade, so that the award is seeking to represent the gain made by the defendant rather than the loss to the claimant;

(c) in the form of special damages to cover compound interest paid by the claimant as a result of the defendant's wrongful act or omission;

(d) in arbitration cases, though the principles on which arbitrators should award compound interest have yet to emerge.

[149] Paras 2.21 and 2.22 above.

[150] Acquisition of Land (Rate of Interest after Entry) Regulations 1995 (SI 1995 No 2262) reg 2. For the Law Commission's current proposals, see para 4.58 below.

[151] See paras 2.25 and 2.30 above.

[152] Paras 2.35 to 2.41 above.

PART III
FOREIGN SYSTEMS OF LAW

COMMONWEALTH AND COMMON LAW SYSTEMS

3.1 Most common law systems have an approach that is recognisably similar to the law of England and Wales. *London, Chatham and Dover Railway Co v South Eastern Railway Co*[1] is accepted as stating the common law, and there is a statutory power to award simple interest on debts and damages.

3.2 In Australia, compound interest can be awarded as general damages where the loss complained of is pecuniary in nature, so that the plaintiff has lost the use of money paid out as a result of the defendant's negligence, without the need for proof that the plaintiff borrowed to cover the loss.[2] In New Zealand, damages representing interest paid have been awarded for the defendant's delay in paying a debt, on the ground that it was reasonably within the contemplation of the defendant that the plaintiff would have to borrow or to incur overdraft interest, without proof of actual knowledge.[3] This would be capable of extending to compound interest if this is what the plaintiff had to pay.

3.3 In some Canadian provinces, such as Nova Scotia, there is no specific exclusion of compound interest and it is sometimes given on debts,[4] and even on damages for non-pecuniary loss.[5] In others, such as Ontario, court-based statutory interest cannot be awarded on any part of a debt which itself consists of court-based statutory interest;[6] but this does not preclude statutory interest being awarded on interest of other types. The Federal courts award compound interest only where authorised by the law of the province in which the cause arises.

3.4 The position in the United States is different, in that the Federal practice is not in any way dependent on state practice. Most states are reluctant to award compound interest as pre-judgment interest,[7] and some, such as New York, even restrict

[1] [1893] AC 429.

[2] *Hungerfords v Walker* (1989) 171 CLR 125.

[3] *Roberts' Family Investments Ltd v Total Fitness Centre (Wellington) Ltd* [1989] 1 NZLR 14; *Cruickshank v Westpac Banking Corporation* [1989] 1 NZLR 114.

[4] *Mathers v Mathers* (1992) 113 NSR (2d) 284 (compound interest due on a wrongfully awarded bonus).

[5] *Armstrong v Baker* (1992) 113 NSR (2d) 420 (interest compounded annually on a non-pecuniary damage award for personal injuries); but compare *ACA Co-operative Assn v Associated Freezers of Canada Inc* (1992) 113 NSR (2d) 1.

[6] Courts of Justice Act RSO 1990, s 128(4).

[7] A E Rothschild, "Prejudgment Interest: Survey and Suggestion" (1982) 77 Northwestern U Law Rev 192, 194; D B Dobbs, *Dobbs' Law of Remedies: Damages, Equity and Restitution* (2nd Edition 1993) s 3.6(4), p 353.

contractual compound interest.[8] Federal courts now do sometimes award pre-judgment compound interest,[9] independently of the law of any state, and this is becoming the norm in large-scale commercial litigation.[10]

CODIFIED SYSTEMS

3.5 Most Continental systems allow pre-judgment interest, but distinguish between "moratory" and "compensatory" interest. (There are other kinds of interest, such as interest under a contract, not falling within either category.)

(1) Moratory interest means the statutory (simple) interest provided in the case of money claims. This is explicitly provided for in the various civil codes:[11] in some systems this provision is confined to claims for a fixed debt, while in others it can also apply to damages for breach of contract. This type of interest is available following formal notice of default, or in some situations as of right, as liquidated damages for delay in payment.[12] Some codes contain a provision allowing a plaintiff to recover damages for delay in excess of the statutory interest rate provided that it can be proved that such damage has actually occurred.[13] This corresponds to the head of damages allowed in *Wadsworth v Lydall*,[14] and can have the effect of allowing recovery of damages representing compound interest that the plaintiff has had to pay. It can also be used to compensate for a loss arising from monetary depreciation.

(2) Continental codes generally contain no express provision for pre-judgment interest on damages, but interest since the cause of action arose (in tort cases), or since notice of the claim (in contract cases), may enter into the computation of general damages. Such interest is called compensatory interest. The rate is at the court's discretion and need not be linked to the statutory rate for moratory interest. As it is common for unliquidated damages (such as for pain and suffering, or for loss of or damage to property) to be assessed as at the date of judgment rather than as at the

[8] *Connecticut v Jackson* 1 Johns Ch R 13 (Ct App 1814); *Young v Hill* 67 NY 162, 177-8 (1876); *Household Finance Corp v Goldring* 263 AD 524, 527, 33 NYS2d 514 (NYAD 1942). The position was modified for loans above $250,000 by an amendment to the General Obligations Law (Chapter 202, 5-527) in 1989.

[9] *Bio-Rad Lab Inc v Nicolet Instrumental Corp* 807 F2d 964, 969 (Fed Cir 1986).

[10] *In the Matter of the Oil Spill by the Amoco Cadiz off the Coast of France on March 16 1978* 954 F2d 1279, 1332.

[11] French and Belgian civil codes, art 1153; German civil code, art 288(1); Greek civil code, art 345; Italian civil code, art 1224; Dutch civil code, art 6:119(1); Portuguese civil code, art 806(1); Spanish civil code art 1108.

[12] Compare the position under Lord Tenterden's Act (para 2.3 above), and the Law Commission's 1987 proposals for statutory interest (para 2.4 above).

[13] German civil code, art 288(2); Italian civil code, art 1224 last sentence; Portuguese civil code, art 806(3). The French civil code (art 1153, last sentence) contains a more limited provision for damage caused in bad faith and independently of the delay.

[14] [1981] 1 WLR 598; para 2.15 above.

date of the incident, compensatory interest may be awarded at a discounted rate net of inflation.[15]

3.6 Continental civil codes generally take a restrictive approach to compound interest, both in the contractual and the judicial fields. The most commonly found pattern is to invalidate prior agreements for compound interest outside the banking field but to provide a mechanism for capitalising interest already accrued.[16] This mechanism can only be used to impose compound interest on sums already ascertained and not retrospectively on awards of damages; but subject to that it generally applies to all kinds of interest whether contractual or statutory, and is not confined to the moratory interest mentioned in the previous paragraph. Capitalisation may be either by agreement or by some sort of formal demand: this demand may vary from a simple notice of default to a full court action. In some cases only one of these possibilities is mentioned: the German civil code only provides (by implication) for capitalisation by subsequent agreement,[17] and the Spanish code only provides for capitalisation by judicial demand.[18] The general sense of the codes is that the agreement or demand only effects a "one-off" capitalisation of interest accrued to date, and must therefore be repeated at intervals: this appears most clearly from the Portuguese code.[19] The French code[20] could be interpreted in this sense,[21] but the prevailing practice is to capitalise interest instalments falling due even after the agreement or demand, thus producing true compound interest.

3.7 The outstanding exception to this pattern is the Dutch code, which is of interest both because it is the most recent among the major Continental codes[22] and because of its similarity to the Principles of European Contract Law.[23] As in the other systems, statutory interest runs on a debt of a "sum of money" from when formal notice (*sommation*) is given to the debtor; but once statutory interest runs at all, it is automatically capitalised at the end of each year.[24] Unlike the provisions for compound interest in the other codes, this capitalisation appears to be confined to moratory interest.

[15] e.g. Italy: L. Lambo, "Sul danno da ritardo nel pagamento del risarcimento del danno" (On the damage caused by delay in the payment of damages) (*Il Foro italiano*, 1999, fascicle 6 part 1 pp. 2061-2). The reasoning is similar to that in *Birkett v Hayes* [1982] 1 WLR 816 (paras 2.49(3) and 2.50 above).

[16] e.g. Greek civil code, art 296; Italian civil code, art 1283; for other systems see the next few footnotes. Compare the reasoning of *ex parte Bevan* (1803) 9 Ves 223, 32 ER 588 (para 2.11 above).

[17] Art 248(1) of the Civil Code excludes agreements for compound interest made "in advance", implying that there can be an agreement for interest on interest already accrued.

[18] Civil Code, art 1109.

[19] Civil Code, art 560.

[20] Civil Code, art 1154.

[21] and is so interpreted in Belgium, where the relevant part of the code is identical to the French.

[22] It came into force in 1992.

[23] Para 3.14 below.

[24] Civil Code, art 6.119.

3.8 Compensatory interest generally falls outside the scope of the article on compound interest; it is not always clear whether the effect of this is that the interest can be compounded free from the constraints of the article or that it cannot be compounded at all. Academic writers generally assume the latter; but it has been held in Belgium that, because the compound interest article does not apply to tort damages, there is no exclusion of interest upon interest in these cases.[25] We have not found any similar decision in the laws of the other countries investigated.

INTERNATIONAL AND SUPRANATIONAL LAW

3.9 In claims against governments, for example for expropriation of property or businesses, international tribunals and arbitrators have traditionally awarded simple interest only.[26] Some scholars have advocated that compound interest should be more widely available;[27] and in recent years there have been decisions to the effect that compound interest is not precluded in principle and may be granted in appropriate cases.[28]

3.10 The European Court of Human Rights habitually awards interest on damages for pecuniary loss.[29] In so doing, it generally follows the rates provided by the domestic law of the country with which the case is connected. Domestic courts, when adjudicating on human rights matters, are required to take into account the jurisprudence of the European Court of Human Rights;[30] in the matter of interest, this means applying the legislation in force in England and Wales.[31] So far as domestic legislation provides a right to interest on a claim (not necessarily a human rights claim), this is a civil right within the meaning of the Convention. The effect of this is not that the Convention has any impact on what interest ought to be given by the substantive law, but only that the fair trial requirements of Article 6 apply to any process by which interest is determined.

[25] Verbraeken and de Schoutheete, "L'anatocisme" [1989] J.T. 101; Cass 29 October 1956 *Pas.* 1957 I 202; Cass 7 November 1986 *Pas.* 1986 I 304.

[26] M Whiteman, *Damages in International Law* (1943), vol 3 para 1997; *J R Reynolds Tobacco Co v Islamic Republic of Iran* (1984) 7 Iran-US CTR 181; *Anaconda-Iran Inc v Islamic Republic of Iran* Award No ITL 65-167-3 (1986) 13 Iran-US CTR 199; *International Systems & Controls Corp v National Iranian Gas Company* Award No 464-494-3 (1990) 24 Iran-US CTR 47.

[27] F A Mann, "Compound Interest as an Item of Damage in International Law", in *Further Studies in International Law* (Oxford 1990) p 383.

[28] *Government of Kuwait v American Independent Oil Company* (1982) 21 ILM 976, 66 ILR 613; *Asian Agricultural Products v Republic of Sri* Lanka (1991) 6 ICSIC Rev-FILJ 526; *Compañia del Desarollo de Santa Elena SA v Republic of Costa Rica* (2000) 39 ILM 1317; *McKesson HBOC Inc v Islamic Republic of Iran* (2001), District of Columbia Court of Appeals No 00-7157; *Pope & Talbot Inc v Government of Canada* (arbitral award of 31 May 2002, unreported).

[29] Law Commission Report on Damages under the Human Rights Act 1998 (Law Com No 266), paras 3.70 to 3.75.

[30] Human Rights Act 1998, s 2(1)(a).

[31] Law Com No 266, paras 4.89 to 4.91.

PROPOSALS FOR LAW REFORM IN OTHER JURISDICTIONS

Canada

3.11 In January 1987 the Law Reform Commission of British Columbia published a Report[32] on the Court Order Interest Act.[33] This recommended that:

(a) pre-judgment interest should remain mandatory as under the existing Act;

(b) there should be a single applicable rate based on the prime lending rate of the Canadian Imperial Bank of Commerce, which should be determined monthly;

(c) interest should be compounded, and determined by reference to a table of multipliers to be published in conjunction with each change of monthly rate; these would reflect all the previous fluctuations in the prescribed rate;

(d) in the case of non-pecuniary damages such as for personal injuries, where the damages are assessed as at the date of judgment, the applicable rate should be the "real" interest rate (i.e. interest less inflation), as prescribed by the Chief Justice under the existing law for the purposes of lost earnings.[34]

3.12 The recommendations in this Report on compound interest have not been implemented. Similar recommendations, also unimplemented, have been made by the Law Reform Commissions of Manitoba[35] and Ontario.[36]

New Zealand

3.13 In 1994 the New Zealand Law Commission published Report No 28, entitled Aspects of Damages: The Award of Interest on Money Claims. This report was influenced by the British Columbia report, and recommended that:

(a) with a few exceptions, there should be mandatory compound interest on all judgments for money claims, at rates fixed by reference to the yield on Government stocks;

(b) this interest should run from the arising of the cause of action until payment, replacing both pre-judgment and post-judgment interest under the existing law;

(c) the compounding should be monthly;

[32] LRC 90.

[33] SBC 1974 c 65.

[34] Law and Equity Act (RSBC 1999 c 224), s 51.

[35] Report on Pre-judgment Compensation on Money Awards (1982); implemented, except as to compound interest, by the Judgment Interest and Discount Act 1986 (SM 1986-87, c 39), since consolidated in other legislation.

[36] Report on Compensation for Personal Injuries and Death (1987).

(d) the current rate, and tables of multipliers reflecting the rates for all periods up to the current rate, should be published periodically in the *New Zealand Gazette*;

(e) mandatory interest should not extend to sums paid before the commencement of proceedings.

This report has not been implemented.

INTERNATIONAL INITIATIVES

Principles of European Contract Law

3.14 The European Parliament, in a resolution of 6 May 1994, put on record the desirability of a common European code of private law; the Commission on European Contract Law accordingly continued work on its existing project aimed at producing a set of principles upon which such a code might be based. The result of this work so far takes the form of Parts I and II of the Principles of European Contract Law, published together in 1999. This document has no official standing in European law, nor has it been adopted into the law of any country. It aims, first, at restating those principles found to be common to all or most European countries and, secondly, at producing ideas for reform whether or not forming part of any existing system.

3.15 Parts I and II provide for simple interest in article 9:508(1) but make no provision for compound interest. Part III is due to be published soon; we understand that the text of the articles has been finalised. It contains a provision on compound interest (article 17:101), which reads:

> Interest payable according to article 9:508(1) is added to the outstanding capital every 12 months. This rule does not apply if the parties have provided for interest upon delay in payment.

The closest resemblance is to the Dutch civil code. The force of the second sentence is to exclude agreements providing for contractual interest on the relevant sum from the scope of the article, as it is for the parties to specify whether such interest is to be compounded or not. Article 9:508 only applies to delay in the payment of a "sum of money", and allows interest from the time when "payment is due": there is no specific mention of interest on damages.

UNIDROIT Principles of International Commercial Contracts

3.16 In 1994 the International Institute for the Unification of Private Law (UNIDROIT) produced a draft code entitled "Principles of International Commercial Contracts". This is intended as a neutral system to be opted into by the parties to contracts spanning more than one country, rather than as a replacement for any national system of law.

3.17 The relevant part of the Principles is articles 7.4.9 and 10, which read:

> *Article 7.4.9*: (1) If a party does not pay a sum of money when it falls due the aggrieved party is entitled to interest upon that sum from the time when payment is due to the time of payment whether or not the non-payment is excused.

(2) The rate of interest shall be the average bank short-term lending rate to prime borrowers prevailing for the currency of payment at the place for payment, or where no such rate exists for that place, then the same rate in the State of the currency of the payment. In the absence of such a rate at either place the rate of interest shall be the appropriate rate fixed by the law of the State of the currency of payment.

(3) The aggrieved party is entitled to additional damages if the non-payment caused it a greater harm.

Article 7.4.10: Unless otherwise agreed, interest on damages for non-performance of non-monetary obligations accrues as from the time of non-performance.

This is silent on compound interest, but leaves it open whether one could argue that, if the aggrieved party is "entitled" to interest, it follows that that interest is a sum of money due which should itself attract interest. As with the Principles of European Contract Law, there is likely to be a further part published which does address compound interest.

PART IV
ARGUMENTS FOR AND AGAINST REFORM

Arguments for compound interest

4.1 The obvious reason for awarding compound interest is that it reflects economic reality. If a claimant should have had money earlier, and in fact had it later, he or she has either missed an opportunity to invest it, or had to borrow to cover, in either case at compound interest. It follows that simple interest can never be relied upon to produce a just indemnity for the claimant for the loss occasioned by the delay in payment. If it does so on a particular occasion, it is a case of compensating errors: the underpayment caused by awarding only simple interest has been cancelled out by an overpayment caused by awarding too high a rate. This is a happy accident: had the period for which interest was charged been shorter or longer, the errors would not have compensated each other.[1]

4.2 The argument is clearest in the case of a liquidated debt where liability is certain. The debtor ought to have paid the principal at the outset. It follows that, if he or she does not, the debtor should at least pay periodic interest. If he or she does not even pay the interest, it follows that it should be aggregated with the principal debt and itself earn interest.[2]

4.3 The argument does not apply to damages in quite the same form. The defendant did not have a known duty to press payment on the claimant at the moment the damage occurred, as both liability and quantum may be disputed: it was perfectly proper to await the decision of the court. However that decision once made is in a sense retrospective as concerns both issues. The purpose of the award is to place the claimant, so far as money can do it, in the same position as if the act or omission complained of had never taken place. It follows that an ideal system of justice should create the same economic effect as if each item of damage had indeed been recompensed at the moment it occurred.[3] This can only be done by compound interest.

4.4 A second argument for awarding compound interest is that it encourages early payment. If payment is made before proceedings are brought, interest will, as now, not be awarded; but if proceedings are brought, the defendant will be liable to interest not only for the period the proceedings are in being but also for all the time the debt was owing before their commencement. The incentive to pay afforded by the prospect of interest will increase if the interest is compounded over that period.

4.5 A variant of this argument is that compound interest encourages defendants to co-operate in bringing about the early resolution of proceedings. Otherwise there

[1] For further discussion of this effect, see para 4.17 below.

[2] See *Waring v Cunliffe* (1790) 1 Ves Jun 99, 30 ER 249 *per* Lord Thurlow.

[3] Michael S Knoll, "A Primer on Prejudgment Interest" (1996) 75 Tex LR 293.

could be a situation in which the award is only growing at simple interest while the defendant can invest the money he or she would otherwise pay at compound interest, thus providing an incentive to prolong the proceedings as much as possible. In most cases, however, any eventual gain of this kind will be more than offset by the extra legal costs incurred, and it is only when the likely award is very large indeed[4] that the interest gain will be a significant factor. This view is confirmed by the results of a questionnaire sent to professional and commercial organisations in January 2000. Nevertheless, even where the possibility of exploiting the restriction to simple interest to make a positive gain is not present, it is still likely that the prospect of compound interest would be a greater psychological incentive to dispose of the proceedings quickly.

4.6 A third argument is that from the disparity between the powers of courts and of arbitrators. Whether or not there is a principled legal objection to the powers of one tribunal being different from those of another, it is certainly an undesirable artificiality. If the underlying purpose of awarding interest is to compensate the claimant, the economic considerations are the same in all tribunals, and the law of interest ought to be as uniform as the law of damages. Also, if there is to be a difference between the powers of different tribunals, it is odd to say the least that the difference should be in favour of arbitrators. It may be that, in conferring this power on arbitrators, the legislature had in mind international arbitrations in commercial and maritime cases which often concern larger sums than most court proceedings; but this would be an argument for conferring similar powers at least on the Commercial and Admiralty Courts.

4.7 A fourth argument could be drawn from the existing practice on judgment debts.[5] If compounding is wrong in principle, then judgment debt interest should also only be charged on the capital sum originally owed; if it is right to charge interest upon interest, this should be generally available and not depend on the timing of the judgment. The present system, of one-off compounding at the time of judgment only, appears somewhat arbitrary.

4.8 It was clear in the judgment in *Westdeutsche Landesbank*[6] that the House of Lords considered that the justice of the case required compound interest and that they were only restrained from awarding it by the express provisions of section 35A of the Supreme Court Act 1981. They also expressed the clear hope that this area of the law would be reformed by the legislature. The implication is that there is no need for a detailed prescriptive regime, and that if an unqualified discretion to award compound interest were introduced the judges would evolve their own principles about when and when not to use it.

Arguments against compound interest

4.9 Compound interest being interest upon interest, it is hard to think of any principled argument against the legitimacy of compound interest that does not also

[4] As in commercial arbitration cases, where this incentive seems to have been regarded as realistic: see the quotation in para 2.44 above.

[5] Para 2.2 above, last section.

[6] [1996] 1 AC 669; see para 2.7 above.

impugn interest as such. If interest is to be charged, and is not to be paid periodically as it arises, it is a debt like any other and should in turn attract interest. Simple interest, accumulated till the end of the period for payment, does not correspond to any economic reality. The main arguments for simple interest are ones of convenience.

4.10 The historical objection to interest was based on the religious prohibition of usury, and this seems to have been felt especially strongly in relation to compound interest. In Roman law, for example, while simple interest was available in a variety of situations, such as late payment of a debt,[7] interest upon interest was (under Justinian) forbidden in all circumstances.[8] The economic defence for the prohibition of usury is that it has a disproportionately oppressive effect on poorer borrowers: the more the borrower needs the loan, the less likely he or she is to be able to repay it, and the more the burden of debt will increase. This is especially the case once the debt has grown large enough to imperil the necessaries of his or her trade and thus reduce his or her earning capacity. Where compound interest is charged, and the borrower is too poor even to be able to service the loan, the effect is still stronger. This is still a relevant consideration in third world economies, and lies behind the prohibition of compound interest in some Latin American countries.[9] It is a feeling held by many that an exponential increase is more frightening and unpredictable than a linear increase, and that to be liable to compound interest in any circumstances is to be on a slippery slope to a situation of hopeless debt. In England and Wales, this concern mainly arises in connection with consumer debt, such as credit cards, hire purchase agreements, rent arrears and fuel bills. Whether there should be special treatment for these is discussed below.[10]

4.11 Another objection to compound interest is that a claimant ought not to be rewarded, or to aggravate the lot of the defendant, simply by waiting longer to claim his or her money: if the delay causes an actual loss or a loss of opportunity, it is the claimant's fault for sleeping on his or her rights. This too, while felt most strongly in relation to compound interest, is in substance an objection to interest as such. The proper remedy for this is not to limit the claimant to simple interest throughout the period of liability but to give the court a discretion to halt interest altogether during any period of culpable delay. This is one of the reasons given for the practice of only awarding interest on damages for pain and suffering from the date of commencement of proceedings;[11] though logically, if this argument is valid it should apply equally to all damages claims.

4.12 The main argument of convenience for simple as against compound interest is that it is easier to calculate, and that its incidence is therefore more predictable from the point of view of the debtor. That is certainly true; but in an age of computers

[7] Dig. 22.1.32.2.

[8] Dig. 22.1.29; Cod. 2.11.20; Cod. 4.32.28.

[9] Brazil, Decree 22.626 of 7 March 1933, art 4; Mexican Civil Code art 2397.

[10] Paras 4.25 and 4.26.

[11] Law Commission Report, Damages for Personal Injury: Non-Pecuniary Loss (Law Com No 257) para 2.38; para 2.33 above.

and one in which members of the public are accustomed to the operation of compound interest in their bank accounts and credit cards, the argument is not very powerful. A mechanism could be devised whereby an interest calculation could be referred for assessment if it became too complicated to be made at the time of judgment, along the lines of the present practice as to costs.[12] In practice the calculation would in most cases be agreed between the solicitors for the parties. One suggested way out of the difficulty is the use of published tables of multipliers,[13] as recommended by the British Columbia and New Zealand reports.[14]

4.13 Another argument of convenience which has been used by the opponents of compound interest is based on the method of calculation.[15] The mathematically correct method, by a continuous exponential curve, presents problems if the rate changes, or part of the principal is repaid, in mid-year. The traditional method of computation, with periodic rests, is mathematically arbitrary. That is, the use of rests leads to sudden jumps between sums outstanding for just under a given number of years or quarters and sums outstanding for just over that number of years or quarters. It could however be argued that, at least in debt cases, that is if anything an advantage in that it induces the debtor to pay quicker. The same rate can also lead to different overall returns depending on the frequency of the rests, though these differences are far less than those between simple and compound interest.

4.14 Opposition to compound interest has been expressed by bodies representing insurers, especially motor insurers, who are concerned that it would lead to increased awards and higher premiums.[16] Similarly there could be legitimate concern about increasing the burden on publicly funded services such as the NHS. There are several possible answers to this.

(1) The argument amounts to saying that one should economise on premiums by systematically under-compensating accident victims. It has certainly been held in recent years that, as the assessment of damages for non-pecuniary loss is in any case subjective, the effect on the wider public interest, such as the general body of taxpayers or assured, is relevant in arriving at a reasonable award.[17] In more philosophical language, considerations of distributive as well as corrective justice are relevant to tort

[12] This was the practice at common law for the assessment of interest due under judgments in default: *Rashleigh v Solomon* (1789) 1 H Bl 252, 126 ER 147; *Andrews v Blake* (1790) 1 H Bl 529, 126 ER 304; *Shepherd v Charter* (1791) 4 Term Rep 275, 100 ER 1016.

[13] Bowles and Whelan, "Compound Interest: Could Multipliers be the Way Forward?" (1986) 136 NLJ 876; see para 4.51 below.

[14] Paras 3.11 to 3.13 above.

[15] Report on Interest (1978) Law Com No 88, Cmnd 7229, para 85.

[16] For example, we are informed by the Law Reform Commission of British Columbia that the Insurance Corporation of British Columbia (ICBC), a Crown Corporation that has a monopoly over the provision of motor insurance in the province, opposes compound interest on these grounds.

[17] *Heil v Rankin* [2001] QB 272 (CA).

law and other compensation schemes.[18] That is not the same as saying that, when an award has been arrived at that is reasonable on other grounds, it should then be cut down in the interests of economy. For this reason, the argument from distributive justice is not applied to pecuniary loss, which is susceptible to precise calculation.[19] As interest is compensation for the detriment caused by being kept out of a sum of money, it is always in the nature of pecuniary damages, even when calculated on a non-pecuniary loss.[20] Further, the under-compensation arising from the exclusion of compound interest is selective and bears hardest on those with the longest and most complicated cases.

(2) The argument from distributive justice is strongest in relation to compensation funded either by tax, or by premiums for compulsory insurance such as motor insurance. This is not in itself sufficient to determine the correct treatment of all debts and damages, pecuniary or otherwise, regardless of who funds them.

(3) Another consideration is arithmetical, and follows from the fact that the rates of simple interest currently awarded are economically speaking too high.[21] If there is concern with the overall scale of compensation, it should be possible to lower the rate of interest awarded in such a way that the total expended on all claims, with compound interest, remains the same as the total now expended with simple interest at current rates. The argument would then concern, not the total cost of a given compensation scheme, but only the distribution of compensation between claimants with shorter and those with longer cases.

4.15 Expanding on the last point, it is possible that the overall effect of our proposals would be to reduce the total burden. On 31 December 2001 the prevailing investment rate, taken at 2 per cent over bank base rate, was 6 per cent.[22] Compounded, this takes seven years to overtake simple interest at 7 per cent (the court's special investment rate on that date) and eleven years to overtake simple interest at 8 per cent (the rate for judgment debts). A graph entitled "Growth of £100" and containing further illustrations of this point will be found in Appendix A, together with a table showing the number of years it takes for growth at compound interest at a lower rate to overtake growth at simple interest at a higher rate, for each pair of rates from 4 per cent to 8 per cent.

4.16 Another factor, in the form of a feeling rather than a principled argument, is that since most other countries have not seen fit to make compound interest on debts and damages generally available, there must be some good reason for this; and certainly, if the law of England and Wales were reformed to make compound

[18] *White v Chief Constable of South Yorkshire* [1999] 2 AC 455; *McFarlane v Tayside Health Board* [2000] 2 AC 59, 83; Lord Steyn, "Perspectives of Corrective and Distributive Justice in Tort Law" (John Maurice Kelly Memorial Lecture, Dublin 2002).

[19] *Heil v Rankin* [2001] QB 297G.

[20] See paras 4.3 and 4.23.

[21] See para 2.53 above.

[22] For our recommendations on the level of rates, see para 4.46 below.

interest generally available it would be a pioneer in the field. However, as explained in Part III of this Consultation Paper, in the Continental codes the restriction on the judicial award of compound interest follows from a policy of restricting or prohibiting stipulations for compound interest in private agreements, which is not comparable with anything in the common law systems;[23] and both the Dutch civil code[24] and the work done on the Principles of European Contract Law[25] seem to indicate an increasing acceptance of compound interest. Similarly most other common law systems, though not allowing compound interest in every case, are somewhat more liberal with it than the law of England and Wales.

4.17 In the end, the question is a fairly narrow one. Compound interest is undoubtedly more correct in principle, but the practical gain may or may not be significant enough to justify the effort of the change. At present the rates of simple interest awarded are somewhat higher than commercial rates of interest, and this goes some way towards offsetting the effect of not compounding. Whether the resulting situation is satisfactory depends partly on how wide the variation in disposal time is between different cases.

(1) If the length of time between the arising of the cause of action and the date of judgment does not vary greatly from case to case, it would be possible to set the rate of simple interest in such a way that the disparity between the interest awarded and what would have been awarded on a commercial rate at compound interest will in most cases not be very significant.

(2) If the length of time for the resolution of a case does vary greatly, simple interest will create an injustice in the longest-running cases. If for example the typical disposal period of a case is five years from the time the cause of action arises, then 7 per cent compound interest will produce approximately the same eventual award as 8 per cent simple interest; but over a disposal period of ten years, the total interest assuming 7 per cent compound interest would be one-fifth more than the total interest assuming 8 per cent simple interest.[26] Other examples may be worked out from the graph entitled "Growth of £100" in Appendix A.

Some studies have already been carried out on the range of disposal times for cases, and the results of these are summarised in Appendix B. Unfortunately these largely concern the time taken from when solicitors are first instructed in a case, rather than from when the damage occurred or the cause of action arose. Even with this limitation, it is clear that there is a considerable variation in disposal times, with cases of serious medical negligence and severe injury at work generally taking the longest time to come to trial: as an illustration, it was found that

[23] Except in some of the American states: para 3.4 above.

[24] Para 3.7 above.

[25] Para 3.15 above.

[26] 7% is chosen as a fairly typical investment rate (measured as bank rate plus 2%) over the period from 1993 to the present; 8% is the rate of interest on judgment debts for the same period.

personal injury claims involving damages of more than £100,000 were particularly likely to take six years or more to determine.

4.18 On the assumption that compound interest at a commercial rate produces the economically correct scale of compensation, it follows that the present system produces some over-compensation in the cases with the shortest disposal times, approximately correct compensation in the cases with disposal times of three to five years, and potentially serious under-compensation in long-running cases. This will lead to significant distortions in two categories of case. In very long-running cases, whatever the principal sum involved, the under-compensation can be a significant proportion of the total award. Conversely, in cases involving very large sums, even if the disposal time is not exceptionally great so that the percentage error is small, the effect of that error taken as a money sum is correspondingly magnified. This gives rise to two questions. First, is the scale of the problem in practical terms sufficient to justify introducing compound interest at all? Secondly, if it is introduced, should it be used in all or most cases, or be kept in reserve for only long-running cases and cases involving large amounts?

4.19 Our present view is that the power to award compound interest should certainly be introduced, as the large scale and long-running cases (such as the large commercial cases and serious personal injury cases) are sufficiently numerous for the potential under-compensation to be more than an academic issue. The question of whether it should be used in the generality of cases is more evenly balanced. Whether there should be a clear presumption in favour of simple or compound interest, or a simple power to award whichever the court sees fit, is considered in greater detail below. To anticipate the conclusion of that discussion, we shall be recommending that the presumption be in favour of awarding compound interest across the board.[27] We shall also be recommending that, both in compound interest cases and in any residual simple interest cases, the applicable rate should be economically realistic, and less than the rates of simple interest currently awarded.[28]

4.20 **Our provisional proposal is that a power to award compound interest should be introduced, and should be available for use in the generality of cases. Whether simple or compound interest is awarded, there should be a reduction of interest rates below the simple interest rates currently awarded. Readers are asked:**

(a) if possible, to provide statistical evidence from their own experience about the range of disposal times in different categories of cases;

(b) whether they agree that compound interest is required in order to do justice in long-running cases and cases involving large amounts;

[27] Paras 4.28 to 4.34 below.

[28] For details of our provisional proposals about interest rates, see paras 4.37 to 4.50 below. For the point about simple interest, see para 4.35 below.

(c) whether any power to award compound interest should be used in the generality of cases or only in the cases involving long disposal times or large amounts.

Arguments for and against a limited power

4.21 If a power to award compound interest is desirable in principle, the next question is whether there should be a fixed statutory distinction between the cases in which it should and should not be awarded.

On debts but not on damages?

4.22 One possible distinction is that between debt and damages drawn above;[29] or, possibly, between pecuniary and other losses. In Australia and New Zealand, for example, compound interest is more readily available on debts than on damages.[30] Similarly, in the Continental systems compound interest can only be claimed on liabilities in fixed sums, on the reasoning that if the principal is not fixed, interest on it cannot be said to have accrued. This however depends on the conception of interest as damages for the wrongful withholding of money; which is certainly one function of interest, but by no means its exclusive function, as the Continental distinction between moratory and compensatory interest shows. The ultimate tendency of this argument would be not to restrict interest on damages to simple interest but to exclude it altogether.

4.23 The justification for pre-judgment interest in English law should be not simply to charge defendants for the use of money which they have wrongfully failed to pay over,[31] but to achieve full indemnity for the claimant for the delay between the loss and the recovery.[32] This does not depend on whether the defendant was to blame for the delay. The point is best explained by reference to the principles concerning remoteness of damage.

(1) A consequential loss, to be recoverable, must be a reasonably foreseeable consequence of the defendant's original act or omission,[33] and that act or omission must be one for which the defendant is responsible (whether on the ground of fault or of strict liability). In that sense, he or she is ultimately responsible for the consequential loss; but there is no requirement that the chain of events by which the consequential loss follows from the original incident should also be the defendant's fault.

(2) The same argument should apply to interest. The original loss was one for which the defendant was responsible; it is reasonably foreseeable that there will be a delay before damages can be recovered, and that the claimant will suffer detriment for that delay. It follows that the defendant should

[29] Para 4.3 above.

[30] Para 3.2 above.

[31] Except in trust cases: see above, paras 2.35 et seq.

[32] See para 4.3 above.

[33] *Hadley v Baxendale* (1854) 9 Exch 341, 156 ER 145 (in contract cases); *The Wagon Mound* [1961] AC 388 (in tort cases).

compensate the claimant for that delay, by paying interest: it is irrelevant that the delay is not itself the defendant's fault. And once it is accepted that the claimant should be compensated for the delay in principle, it follows that compound interest should be available, as this is the only way of measuring the detriment accurately.

To measure gains but not losses?

4.24 A second distinction is that made in the equity cases, where compound interest is allowed without proof as a measure of the defendant's presumed gain, but not of the claimant's presumed loss. This distinction appears somewhat arbitrary: if it is right to presume that a defendant invests his or her money in a given way, it should equally follow that the claimant would have done the same if the money had been available to him or her. Also, whether or not the defendant (or the claimant) is in business, in modern conditions it seems reasonable to presume that the effect of having a sum of money over a period is to have the opportunity either to invest that much more, thus obtaining compound interest, or borrow that much less, thus saving compound interest. Nor is the distinction based on whether or not there is a direction to accumulate very defensible: it depends on the notion, surely obsolete, that arrears of income should not attract any interest at all. All income from a trust is either accumulated or paid to a beneficiary. If it should have been accumulated, the trust has lost out on an investment. If it should have been paid to a beneficiary, it should earn interest like any other debt. An analogous argument applies in the partnership situation.[34]

Exclusion of consumer debt?

4.25 A question that has given us considerable concern is whether making pre-judgment compound interest the norm would bear unduly hardly on consumers, given that in many cases their delay in payment is caused by inability rather than unwillingness to pay. One option is therefore to exclude consumer debt from the scope of any power to award compound interest that is introduced.

4.26 As against that, there are three counter-arguments.

(1) If a power to award compound interest is introduced, the award of interest as such will remain discretionary. It will therefore be possible, as at present, to give judgment without any interest if it is felt that the effect of awarding interest would be oppressive. It appears that for those debts most associated with poverty, that is rent and fuel arrears, district judges would be extremely unlikely to award pre-judgment interest,[35] though we would be grateful for any contrary evidence on this point.

(2) The principal remaining categories of consumer case in which considerable debts arise and attract interest are probably loan agreements,

[34] Paras 2.23 above and 4.59 below.

[35] For example J Nixon et al, *Housing Cases in the County Courts* (Policy Press 1996), contains a detailed account of District Judges' approach to housing arrears, which does not include the award of interest.

credit card cases and hire purchase cases. In each category of case, contractual compound interest is already payable on the arrears.

(3) As previously mentioned,[36] the introduction of a power to award compound interest would be accompanied by a reduction in the applicable rate. Since most cases of consumer debt are dealt with fairly shortly after the debt is incurred, the effect could well be to lower the total burden of consumer debt; or at least to shift the burden from the shortest-running to the longest-running cases.

After some hesitation we have concluded that there is no strong case for giving 'consumers' a specific exemption from the proposed regime. The award of any interest at all, let alone compound interest, should remain discretionary save where agreed between the parties, as at present.

4.27 **We provisionally conclude that the power to award compound interest should not be limited to, or excluded in relation to, any particular category of claim. Readers are asked:**

(a) whether they agree with this conclusion, as concerns the options of excluding compound interest in

(i) damages cases as opposed to debt cases;

(ii) compensation for losses as opposed to the restitution of benefits;

(iii) consumer debts;

(b) whether some other distinction should be drawn between the cases in which compound interest should and should not be available.

Compound interest: rule, presumption or simple discretion?

4.28 It is beyond the scope of this Consultation Paper to discuss whether interest as such should be available as of right. We do however need to consider whether the court should have a free choice between simple and compound interest, or whether there should be a rule or presumption to the effect that, if interest is to be awarded at all, it should be compound. (The same question will arise in connection with the rate, and is considered below.[37]) The possibilities are as follows:

(a) to keep section 35A of the Supreme Court Act 1981 in roughly its existing form, with simple interest as the norm, while adding a power to award compound interest where the interests of justice require: compound interest would only be awarded in practice in long-running cases or those involving large amounts;

[36] Paras 4.14(3) and 4.17 above.

[37] Paras 4.37 to 4.50 below.

(b) to amend section 35A along the lines of section 49 of the Arbitration Act 1996: courts would have the power to award simple or compound interest as they saw fit, without any statutory indication of a preference;

(c) to make compound interest the default position: simple interest would then probably be awarded mainly in small debt cases, for example where the disposal period is just over a year, or otherwise where the difference between simple and compound interest is likely to be insignificant;

(d) to make it a fixed rule that, when interest is awarded at all, it must be compound, as in the British Columbia and New Zealand proposals.

4.29 Possibility (d) is the most desirable as a matter of pure mathematical or economic theory. It is, however, likely to raise serious concerns with consumer interests, and to be considered by judges and litigants to be too inflexible and to import excessive complications into small cases.

4.30 Possibility (b) leaves the question of convenience to the courts, though as seen from the practice of arbitrators[38] the pattern would be hard to predict. If a general power to award compound interest is introduced, the courts may decide to make use of it in all or most cases. Alternatively they may decide only to use it where the sums involved are very large, or the time scale is very long, so that the difference between simple and compound interest results in significant sums. This being a question of degree, there would be no particular benefit in attempting to reflect any such distinction in the statutory powers, for example by limiting the power to award compound interest to the Commercial and Admiralty Courts.

4.31 One powerful argument against a purely discretionary system (possibility (b)) is that from predictability. Every factor making for unpredictability in the final amount recovered is an obstacle to the settlement of a case; and a discretionary system might risk a proliferation of satellite litigation in the form of special hearings to resolve the correct interest, as at present happens with costs.

4.32 A specific application of the above argument concerns the system of money paid into court under Part 36 of the Civil Procedure Rules. As explained,[39] the money paid into court includes interest up to the last day for acceptance; at the end of the case this is compared with the award actually made, also with interest up to that day. For this to work the defendant must be able to predict the interest likely to be awarded, so as to calculate what should be paid in.

(1) If compound interest is to be awarded as a matter of course in all or most cases, it will be possible to operate the system as at present, except that the defendant will have to allow compound interest in deciding on the amount to be paid in, and the comparison to be made at the end of the case will

[38] Para 2.45 above.

[39] Para 2.46 above.

incorporate compound interest on both sides of the equation. The only problem arises if the applicable rate of interest changes during the period that the offer is open. This problem exists equally under the present system, and can be met by paying in an additional amount where necessary; but this is a ground for arguing that the rate should not change too frequently.

(2) If however simple interest remains the norm and compound interest is only awarded as a matter of discretion in some cases, payments into court will only include simple interest to the final date of acceptance. Where compound interest is in fact awarded at the end of the case, the comparison between the amount awarded and the amount in court will be skewed in favour of the claimant, thus providing a disincentive to accepting the offer in marginal cases.

4.33 If a power to award compound interest is introduced by way of amendment of section 35A of the Supreme Court Act 1981, it is therefore desirable to give some indication of whether simple or compound interest is considered to be the default position, and to consider whether there is a need to amend CPR Part 36. If compound interest is to be the default position, the comparison to be made between the money paid into court and the final award remains accurate. Any complication is purely arithmetical, and no amendment to the rules is needed. If simple interest is to be the default position, it will need to be provided that, when money is paid into court, only simple interest can be awarded on that sum from the date the cause of action arises until the last day for acceptance. It will still be possible to award compound interest on so much of the award as exceeds the money paid into court, and on the whole award from the last day for acceptance until judgment.

4.34 The choice would thus seem to be between possibilities (a) (simple interest as default position) and (c) (compound interest as default position). The arguments in paragraphs 4.21 to 4.26 tend to show that there is no clear class of case in which simple interest should be awarded for preference. The main argument in favour of possibility (a) is simplicity of calculation, especially in small cases. However, given the possibility of devising a computer program for compound interest,[40] we do not find this argument very powerful. The logic therefore appears to be in favour of possibility (c).

4.35 Another argument against possibility (a) is that it would lead to an overall increase in the burden on insurers and publicly funded schemes. A system in which compound interest is awarded in all or most cases could be financially neutral, in that the extra cost of awarding compound interest in the longest cases could be offset by the saving in the shortest cases, given that the rate of interest would be reduced.[41] If however the courts continue awarding simple interest at the present rates in short and straightforward cases, and reserve compound interest for the longest cases, the effect would be to incur the extra cost without the saving, so that the public and the premium payers have the worst of both worlds. For this reason,

[40] Para 4.53 below.

[41] See para 4.14 above.

if simple interest is retained as an option (whether or not it is the default option), it should be awarded at the same commercially based rates as compound interest, and not at higher rates as at present.

4.36 **Our provisional proposal is that section 35A be amended to state that any interest awarded shall be compound unless there are good reasons to the contrary. Readers are asked whether they agree with this proposal or whether they consider that there should instead be:**

(a) simple interest as the default position, with power to award compound interest where the interests of justice require;

(b) a discretion to award simple or compound interest, with no statutory presumption in favour of either; or

(c) a mandatory rule that all interest awarded must be compound.

Rates of interest

Should there be a prescribed rate?

4.37 The next question is whether, in cases where compound interest is awarded, it should be at:

(a) a prescribed rate to be made mandatory in all cases where compound interest is awarded at all;

(b) a prescribed rate, unless the court considers that there are good reasons for a different rate; or

(c) such rate as the court sees fit, without any prescription at all.

4.38 One advantage of a mandatory rate is that it allows the use of official tables of multipliers, as recommended by the British Columbia and the New Zealand reports. It should be noted that they made this recommendation in the context of a system in which the award of compound interest as such would also be mandatory, and it may be thought that the resulting loss of flexibility is too high a price to pay for the convenience of tables. It may be partly for this reason that neither of these reports has been implemented. The use of tables is further considered below.[42]

4.39 The opposite extreme would be to amend section 35A of the Supreme Court Act 1981 by omitting the word "simple" wherever it occurs and introducing a power to award compound interest at such rates and with such rests as the court considers just (while still possibly creating a presumption in favour of compound interest as such). This possibility is open to the same objections as the proposal for a free choice between simple and compound interest: the lack of predictability would be

[42] Paras 4.51 and 4.52 below.

an obstacle to the settlement of cases, and there would be a difficulty in assessing money to be paid into court.[43]

4.40 The probable result of a pure discretion without a prescribed rate would be the perpetuation of the existing practice in choosing rates. (This result would be even more probable if there is no presumption in favour of compound interest.) This leads to the question of whether the present variety of rates is justifiable.

(1) The use of the judgment debt rate is understandable, in that it is desirable that the same debt should attract the same rate of interest before and after judgment. However the judgment debt rate has for several years been considerably in excess of commercial rates of interest, and would therefore lead to overcompensation if compounded. Ideally the judgment debt rate would also be reduced to commercial rates but made compound; but if this is not practicable it would be better for the pre-judgment rates to reflect commercial rates rather than the judgment debt rate.

(2) Much the same arguments could be applied to the use of the special investment rate for money paid into court; though as we have seen, money in court does in fact earn compound interest.[44] There seems to be no rational distinction between the cases in which interest follows judgment debt rates and those in which it follows the special investment rate; and indeed the original reason for the adoption of the then short-term investment rate (in *Jefford v Gee*[45]) was that the rate for judgment debts was at that time fixed by statute at an unrealistic 4 per cent.

(3) At present, in those cases where the courts do award compound interest, commercially based rates, such as 1 per cent over bank rate or over LIBOR, are used rather than the prescribed rates mentioned in the last two sub-paragraphs. This is clearly right, as the judgment debt rate and the special investment rate are higher and would produce over-compensation if compounded. However, rates such as 1 per cent over bank rate are also sometimes awarded in simple interest cases; and it is not clear why this happens in some cases whereas the special investment rate (for example) is used in others. The same could be said of the practice in trust cases. If compound interest became the rule rather than the exception, it would be preferable for these distinctions to be removed, probably by using rates based on bank rate in the generality of cases.[46]

4.41 The two special cases in which there is an objective reason for a different rate are damages for loss of earnings (attracting interest at half the normal rate) and the pain and suffering element of personal injury awards (attracting interest at 2 per cent). Both these approaches are justifiable in principle, but it may be necessary to review the exact method of calculation.

[43] Paras 4.32 and 4.33 above.

[44] Para 2.47 above.

[45] [1970] 2 QB 130.

[46] Including the residual simple interest cases: para 4.35 above.

(1) The loss of earnings cases assume that the loss accrues continuously and evenly over the period in question. Where simple interest is awarded, the correct amount of interest may be obtained equally by applying half the normal rate to the total amount over the whole period (as is the present practice), or by applying the full rate to that amount over half of the period. In the case of compound interest, neither of these methods is quite accurate. This may be illustrated by assuming a sum of £200,000 payable over 10 years in equal annual instalments in the middle of each year. The total interest, applying the different possible methods, is as follows:

(a) 8 per cent simple interest, calculated on each instalment as it falls due, yields a total of £80,000;

(b) 4 per cent simple interest, on the total sum over 10 years, also yields £80,000 (and 8 per cent simple interest over 5 years gives the same result);

(c) 7 per cent compound interest, calculated on each instalment as it falls due, yields a total of £86,000.47;

(d) 3.5 per cent compound interest, calculated on the total sum over 10 years, yields £82,119.75;

(e) 7 per cent compound interest, calculated on the total sum over 5 years, yields £80,510.35;

(f) 7 per cent compound interest, calculated on the total sum over 10 years and then halved, yields £96,715.14.

In a case where a loss accrues gradually, and fairly evenly, over a period and the total amount is not exceptionally large, method (d) provides a reasonable approximation to the desired result (method (c)).

(2) In a case of gradually accruing loss which does not accrue evenly over the period, such as medical expenses, any method involving the application of a single rate to the total amount may produce serious distortions. In these cases the only accurate method is to calculate separately the interest on each year's expenses, as in method (c).[47]

(3) The present practice of awarding 2 per cent on non-pecuniary personal injury damages is based on the assumption that the damages are assessed by reference to the value of money at the date of the award, rather than at the date of the pain and suffering, so that the interest rate should be net of inflation. *Birkett v Hayes*,[48] which is the authority for this practice in personal injury cases, was decided in 1982, and 2 per cent may have borne some relation to the then rate of interest net of inflation; but it cannot be

[47] The same recommendation, though without reference to compound interest, has been made in the Law Commission's report on Damages for Personal Injury: Medical, Nursing and Other Expenses; Collateral Benefits (Law Com No 262), paras 7.5 to 7.16.

[48] [1982] 1 WLR 816.

assumed that this will always be the case. It may be desirable to follow some flexible indicator, such as the rate of return on index-linked stocks.[49] Given that both market interest rates and inflation operate in a compound interest fashion, it would make sense for the inflation-free rate for personal injuries also to be compounded. However, for reasons given in our Report on Damages for Personal Injury: Non-Pecuniary Loss[50] we do not consider that there is any need for legislative change to the rate of interest in these cases: it can be left to the courts to consider whether the rate should be increased or a system of linking to index-linked stocks be adopted.

4.42 Another reason for flexibility is that there are legitimate reasons for taking into account the circumstances of the claimant in quantifying the scale of the loss which interest is designed to compensate. The basis for awarding compound interest on debts or damages is that it represents the presumed loss of the claimant, either through missing the opportunity to invest the money or through having to borrow to cover the shortfall. The question therefore arises of whether the rates awarded should represent investment or borrowing rates, and in either case the rates applicable to what class of customer. In the generality of cases, interest should be awarded at a rate reflecting investment rates available to private individuals. In other cases, the court might award borrowing rates, such as where it is known that the claimant is in trade and needs to operate on an overdraft; and different rates again might be used where the claimant is not a private individual.

4.43 The proposal for a mandatory prescribed rate should therefore be rejected, as not allowing the court to award lower rates in personal injury cases or to take proper account of the circumstances of the claimant. The proposal for a free choice of rate without any prescription is equally undesirable, both on the ground of unpredictability and because it would encourage the retention of arbitrary distinctions from the existing practice.

4.44 **Our provisional proposal is that the power in section 35A(1) of the Supreme Court Act 1981 should be used to prescribe a standard rate, and that the section should provide that this rate shall be used unless there is good reason to the contrary. This rate should also be used when simple interest is awarded. Readers are asked whether they agree with this proposal, or whether they consider that there should instead be**

(a) a mandatory prescribed rate; or

(b) freedom to choose a rate in each case without any prescriptive guidance.

How should the prescribed rate be set?

4.45 The next question is how this rate should be set. One possibility would be to set the rate at intervals by statutory instrument, like the existing rate for judgment debts. In our opinion it would be preferable for the rate to be pegged to some

[49] For a similar system, see the recommendation for British Columbia, para 3.11(d) above.

[50] Law Com No 257 paras 2.46 to 2.58.

current economic indicator, such as bank rate. For reasons of convenience,[51] it would be desirable for the rate to change at intervals of a calendar year, rather than with each individual fluctuation of bank rate. For example, it could be provided that, on 1 January in each year, the prescribed rate would change to a given number of percentage points above the average of the bank rate prevailing at the beginning of each of the three preceding months. The formula would be set out in a statutory instrument, and it would be necessary to ensure that the statutory powers were wide enough to permit this to be done.

4.46 The level at which the prescribed rate should be set has caused us some difficulty, though as explained above there would be liberty to depart from it where the circumstances of the claimant require. The possibilities seem to be as follows:

(a) bank base rate, or 1 per cent above: this would reflect the circumstances of large financial institutions, and also correspond to the best rates which a private individual can obtain by investing money in a bank or building society;

(b) 2 to 3 per cent above base rate: this corresponds to the return available on investment in equities or property, and to the mortgage rates payable by private individuals;

(c) 4 per cent above base or more, to correspond with the borrowing rates available to medium-sized businesses.[52]

Of these, possibility (b) seems to us to strike the right balance between lending and borrowing rates, and to reflect the fact that the most likely use for a substantial sum of money by an individual in average circumstances is in paying off one's mortgage.

4.47 **Our provisional proposal is that the prescribed rate should be set by reference to bank base rate, at a level designed to reflect the market investment rates available to, or the mortgage rates payable by, private individuals. Readers are asked whether they agree with this proposal, or consider that the level should be set on some other principle, such as bank investment or business borrowing rates.**

4.48 Another question concerns the frequency of rests. There are arguments in favour of the rests being annual, to enable ready comparison with the rates charged or paid by different financial institutions, which generally quote an APR (annualised percentage rate); quarterly, in accordance with the usual practice of the banks; or half-yearly, like the interest paid on money in court. If the suggestion about prescribed rates and published tables of multipliers is adopted, the compounding should be at the same intervals as the revision of rates and tables.[53]

[51] In particular, in calculating payments into court: para 4.32(1) above.

[52] See para 2.25 above.

[53] Hence the monthly rests in the recommendations of the British Columbia and New Zealand bodies (paras 3.11 to 3.13 above).

4.49 To simplify the calculations in short-running cases, we are minded to recommend that compound interest be computed with annual rests: this is also the approach of the Principles of European Contract Law.[54] This would be consistent with the recommendation that the prescribed rate should change at intervals of a year. As with the rates, the court would be able to order more frequent rests in an appropriate case.

4.50 **Our provisional proposal is that compound interest should be computed with annual rests unless the court considers that there are good reasons for ordering rests at more frequent intervals.**

How would interest be calculated in practice?

4.51 It has been suggested, for example by the Law Reform Commission for British Columbia, that the difficulties of calculation could be surmounted by the use of officially sanctioned tables of multipliers which would be published monthly together with the current rate of interest.[55] This would only be possible if, at the same time, the present flexibility in choosing rates of interest were abolished and a single applicable rate imposed, even if based on a fluctuating indicator.

4.52 Our recommendation is that there should indeed be a prescribed rate, for use in normal cases, but with liberty to order interest at a different rate for good reason: in an appropriate case, the court might order interest at (say) 2 per cent above, or below, the prescribed rate.[56] In theory there could be tables published for the prescribed rate and for a range of percentage points above or below it; such tables would not be part of any instrument prescribing the rates, and could be produced by the private sector. In practice, we consider that this would be somewhat cumbersome.

4.53 As an alternative to tables, compound interest could be calculated by a simple computer program. A possible mode of operation would be as follows:

(a) section 35A of the Supreme Court Act 1981 would contain a power to prescribe rates, as at present, and would specifically state that a rate may be prescribed by a formula derived from current economic indicators, rather than by stating figures in the prescribing instrument itself;

(b) the instrument would then provide that the applicable rate for each calendar year is (for example) 2.5 per cent above the bank base rate for the preceding year, with some formula such as the average for selected dates in that year;

(c) judgment in each case would be for a given sum together with interest (which would mean compound interest at the prescribed

[54] Para 3.15 above.

[55] Para 3.11 above.

[56] Paras 4.42 to 4.44 above.

rate), or without interest, or with interest at so many per cent above or below the prescribed rate;

(d) there would be a computer system common to all courts, which would contain information on the prescribed rate for each year since the introduction of the system;

(e) upon or after judgment, the judge, master or district judge would be presented with a computerised form: in the appropriate boxes, he or she would enter the date of judgment, the year from which interest is to be computed, the amount awarded and the rate of interest (from a set of options, including a range of percentage points above and below the prescribed rate, and a range of fixed rates[57]); the computer would then calculate the amount of interest accrued at the date of the judgment;

(f) in cases of continuing expense, one could enter the amount incurred in each successive year; the same system could be used in cases where the defendant had made part payments over the years, by entering negative amounts;

(g) where the rate of expenditure was reasonably constant, there would be an option to enter a total amount and a range of years.

4.54 **Readers are asked for their views on the relative expediency of calculating interest by means of a computer program, of tables of multipliers and by any other method they may suggest, and to comment on any practical difficulties likely to arise.**

Effect on other types of interest

Interest under various statutes

4.55 One remaining problem is whether cases in which simple interest is available as of right, such as tax cases, should be excluded from the scope of the section or whether there should be a discretion to compound such interest in an appropriate case.

4.56 In tax cases (and other comparable schemes), the options are:

(a) to amend the particular statutes providing for interest so as to require or permit the statutory interest to be compounded;

(b) to leave the particular statutes in their existing form, but to allow interest to be charged under section 35A of the Supreme Court Act 1981 upon the total amount charged by the relevant statutory demand, inclusive of statutory interest;

[57] These might be used, for example, if it was desired to award compound interest at 2% for non-pecuniary loss in a personal injury case.

(c) to exclude these cases from compounding altogether, allowing statutory simple interest to be charged as at present.

Detailed responses on this point will be sought from the Inland Revenue and other interested bodies. At present the Commission inclines to the view that, since these liabilities have their own dedicated enforcement machinery and do not depend on ordinary debt actions, it is best to leave them outside the scope of the proposed reforms.

4.57 We see no need to alter the scheme of the Late Payment of Commercial Debts (Interest) Act 1998. There is however a problem about its interaction with section 35A of the Supreme Court Act 1981. At present, interest under section 35A is not available if the claimant is entitled to interest for any other reason. In the current state of section 35A this does not matter, as interest under the 1998 Act will always exceed that which would have been awarded under section 35A. If interest under section 35A becomes compound, this will no longer always be the case. The 1998 Act was intended to create an incentive for prompt payment in the short term, and not to restrict the interest otherwise available in the long term. Any new legislation should therefore be framed so that the claimant has the option of claiming interest under whichever head is more favourable given the length of time since the cause of action arose. (The same could conceivably be done in the case of other types of statutory interest, such as interest on tax.)

4.58 The rules relating to interest in land compensation cases are discussed in the Law Commission's Consultative Report entitled "Towards a Compulsory Purchase Code: (1) Compensation".[58] The Compulsory Purchase Policy Review Advisory Group, in their Final Report published in July 2000, recommended that the applicable rate should be increased so as to be comparable to investment rates, and that compound interest should be available.[59] The Law Commission's Consultative Report made no recommendations on compound interest, but proposed to await the conclusions of the present project. If in the light of this paper it is decided to extend the power to award compound interest to courts generally, there seems no reason in principle why the same should not apply to compensation awarded by the Lands Tribunal. However, to make firm recommendations about interest in land compensation cases is outside the scope of this Consultation Paper.

4.59 Interest following dissolution of a partnership[60] is discussed in a previous Consultation Paper.[61] This recommends, first, that a rate pegged to an economic indicator should be substituted for the statutory rate of 5 per cent and, secondly, that the alternative option of taking an account of the actual profits should be removed.[62] The question of simple or compound interest was deliberately left for

[58] Consultation Paper No 165, paras 8.33 to 8.48; see also paras 2.21 and 2.22 above.

[59] CPPRAG Review, page 68 para 179. In its response to the report, the Government stated that it would review the issue in the light of this Consultation Paper and the Law Commission's review of other compensation issues: Compulsory Purchase and Compensation: delivering a fundamental change (DLTR 2000), Appendix para 3.74.

[60] Para 2.23 above.

[61] Partnership Law, Consultation Paper No 159.

[62] *Ibid* para 7.26.

consideration in the present project. For reasons analogous to those given for trust cases,[63] we consider that interest in this situation should be compound. If 5 per cent of the value of the assets (or whatever variable rate is prescribed in its place) is a reasonable estimate of the annual profit, it follows that either the former partner's share of that profit should have been paid out year by year, or it should be treated as re-invested in the trade. In the first case each instalment should attract interest like a debt; in the second case it should attract interest as if it were additional capital in the name of the former partner.

4.60 **Our provisional proposals are that:**

(a) in general, cases where statutory interest is available should be excluded from any general power conferred on the court to award compound interest;

(b) in the case of the Late Payment of Commercial Debts (Interest) Act 1998, claimants should be allowed whichever is greater out of simple interest under the Act and compound pre-judgment interest;

(c) section 42 of the Partnership Act 1890 should be amended so as to allow persons leaving a partnership or the estates of such person to receive compound interest on their shares of the partnership assets at a commercial rate.

We make no recommendation specific to interest on compensation in compulsory purchase and planning cases.

Interest under rule 36.21 of the Civil Procedure Rules

4.61 The question remains of how to deal with the additional interest on damages and costs provided by CPR rule 36.21 in a case where the claimant's Part 36 offer has been refused:[64] that is to say,

(a) whether that interest should itself be compound; and

(b) whether the cumulative interest limit of 10 per cent over base[65] should be compound.

4.62 Any of the possibilities gives rise to arithmetical complications.

(1) If the cumulative interest limit remains simple, the condition can never be satisfied: if interest under section 35A of the Supreme Court Act is compound, then given a sufficient number of years the total of the section 35A interest and the rule 36.21 interest, however low the rates, must exceed the cumulative interest limit. If this possibility were adopted, the

[63] Para 4.24 above.

[64] Para 2.48 above.

[65] CPR, r 36.21(6); above, para 2.48 last sentence.

rule would have to be amended so as to provide, not that the rate chosen must be such that the cumulative interest will never exceed 10 per cent over base, but that in any given year the excess over the cumulative interest limit is irrecoverable.

(2) If the cumulative interest limit is compound, there are difficulties of calculation arising from the fact that two separate streams of interest are charged on the same sum. Unlike in the case of simple interest, the rate for the sum of two streams of compound interest cannot be obtained by adding the rates for the streams. For example, if a sum of £100 attracts two streams of compound interest at 5 per cent each the total amount owing will be £120.50 after two years and £155.26 after five years, whereas if it attracts a single stream of interest at 10 per cent the total amount will be £121 after two years and £161.05 after five years.

4.63 **Our provisional proposal is to amend CPR rule 36.21 to provide that compound interest at a rate of up to 10 per cent over base may be awarded instead of any (lower) interest that would otherwise be payable. Readers are asked for their views on whether the rate of interest under that rule should be set somewhat lower than 10 per cent over base to compensate for the effect of compounding.**

Interest in equity cases

4.64 Another problem, if the main recommendation is adopted, is whether to provide specifically that the new system is to be applied to interest in equity cases, given that such interest does not at present fall within section 35A.

(1) The argument in favour of reform is that the present practice is unclear and contains arbitrary distinctions, particularly as concerns the applicable rates.[66]

(2) The argument against reform is that the practice is necessarily discretionary, and follows what is felt to be just in particular cases, so that it does not lend itself to codification. If there are arbitrary exceptions, such as unduly restrictive conditions for awarding compound interest, or (formerly) the unavailability of interest on arrears of annuities, these are conditioned by the historical absence of interest at common law. Thus, if the general law were reformed to allow for compound interest on debts, the equity practice could well be influenced in the direction of making compound interest generally available, without the need for reforms specifically applicable to the equitable jurisdiction.

4.65 **Our provisional conclusion is that there is no need for statutory reform of the practice under the equitable jurisdiction.**

[66] The argument is elaborated in more detail above, in paras 4.24 and 4.39(3).

The impact of our proposals

4.66 The effect of making compound interest generally available would be to alter the balance in favour of claimants in long-running cases, and to that extent to increase the burden on publicly funded compensation schemes and insurers. As argued above, this effect would be to some extent offset by the reduction of the burden in the shortest cases, given that the rates of interest would be reduced.[67]

4.67 **Readers are asked for any comments and evidence they may have about the benefits and costs of our proposals, including their main practical and economic impact upon different interests.**

[67] Paras 4.14(3) and 4.15 above.

PART V
PROVISIONAL PROPOSALS

5.1 A power to award compound interest should be introduced, and should be available for use in the generality of cases. Whether simple or compound interest is awarded, there should be a reduction of interest rates below the simple interest rates currently awarded. Readers are asked:

(a) if possible, to provide statistical evidence from their own experience about the range of disposal times in different categories of cases;

(b) whether they agree that compound interest is required in order to do justice in long-running cases and cases involving large amounts;

(c) whether any power to award compound interest should be used in the generality of cases or only in the cases involving long disposal times or large amounts. (Paragraph 4.20)

5.2 The power to award compound interest should not be limited to, or excluded in relation to, any particular category of claim. Readers are asked:

(a) whether they agree with this conclusion, as concerns the options of excluding compound interest in

(i) damages cases as opposed to debt cases

(ii) compensation for losses as opposed to the restitution of benefits;

(iii) consumer debts;

(b) whether some other distinction should be drawn between the cases in which compound interest should and should not be available. (Paragraph 4.27)

5.3 Section 35A should be amended to state that any interest awarded shall be compound unless there are good reasons to the contrary. Readers are asked whether they agree with this proposal or whether they consider that there should instead be

(a) simple interest as the default position, with power to award compound interest where the interests of justice require;

(b) a discretion to award simple or compound interest, with no statutory presumption in favour of either; or

(c) a mandatory rule that all interest awarded must be compound. (Paragraph 4.36)

5.4 The power in section 35A(1) of the Supreme Court Act 1981 should be used to prescribe a standard rate, and the section should provide that this rate shall be used unless there is good reason to the contrary. This rate should also be used when simple interest is awarded. Readers are asked whether they agree with this proposal, or whether they consider that there should instead be

(a) a mandatory prescribed rate; or

(b) freedom to choose a rate in each case without any prescriptive guidance. (Paragraph 4.44)

5.5 The prescribed rate should be set by reference to bank base rate, at a level designed to reflect the market investment rates available to, or the mortgage rates payable by, private individuals. Readers are asked whether they agree with this proposal, or consider that the level should be set on some other principle, such as bank investment or business borrowing rates. (Paragraph 4.47)

5.6 Compound interest should be computed with annual rests unless the court considers that there are good reasons for ordering rests at more frequent intervals. (Paragraph 4.50)

5.7 Readers are asked for their views on the relative expediency of calculating interest by means of a computer program, of tables of multipliers and by any other method they may suggest, and to comment on any practical difficulties likely to arise. (Paragraph 4.54)

5.8 On statutory interest:

(a) in general, cases where statutory interest is available should be excluded from any general power conferred on the court to award compound interest;

(b) in the case of the Late Payment of Commercial Debts (Interest) Act 1998, claimants should be allowed whichever is greater out of simple interest under the Act and compound pre-judgment interest;

(c) section 42 of the Partnership Act 1890 should be amended so as to allow persons leaving a partnership or the estates of such person to receive compound interest on their shares of the partnership assets at a commercial rate.

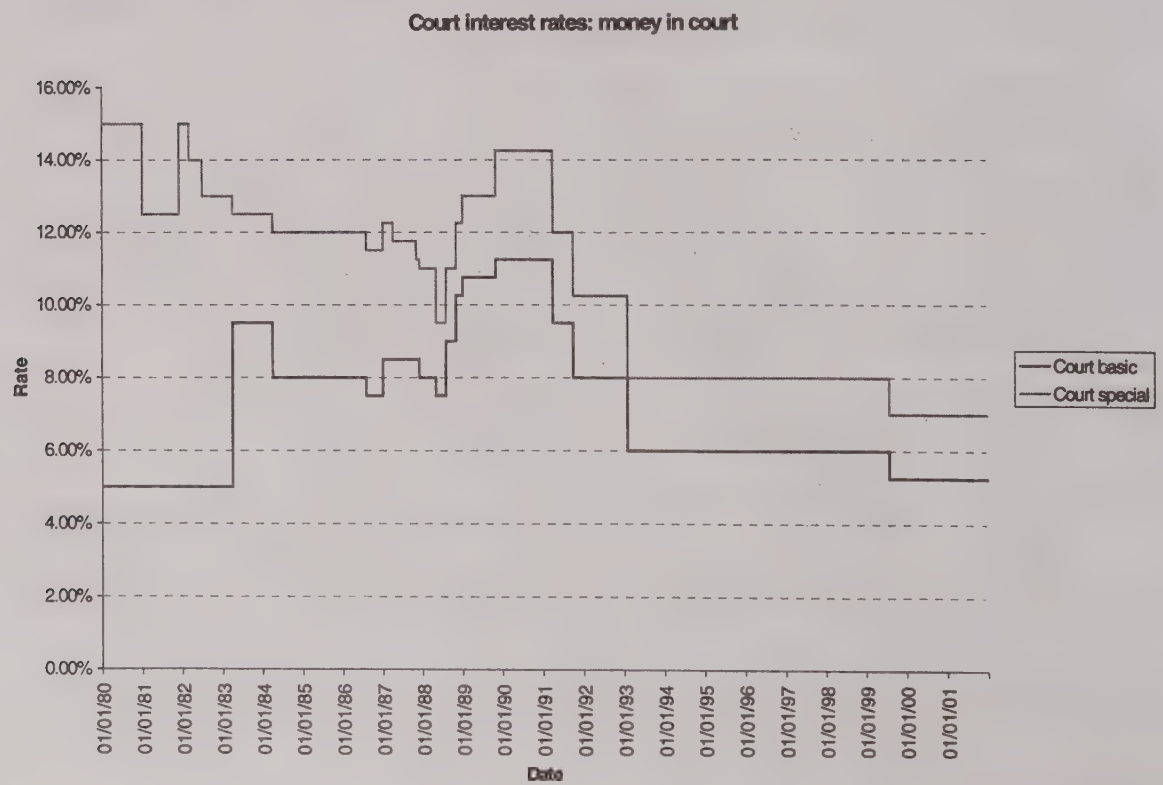
We make no recommendation specific to interest on compensation in compulsory purchase and planning cases. (Paragraph 4.60)

5.9 CPR rule 36.21 should be amended to provide that compound interest at a rate of up to 10 per cent over base may be awarded instead of any (lower) interest that would otherwise be payable. Readers are asked for their views on whether the rate of interest under that rule should be set somewhat lower than 10 per cent over base to compensate for the effect of compounding. (Paragraph 4.63)

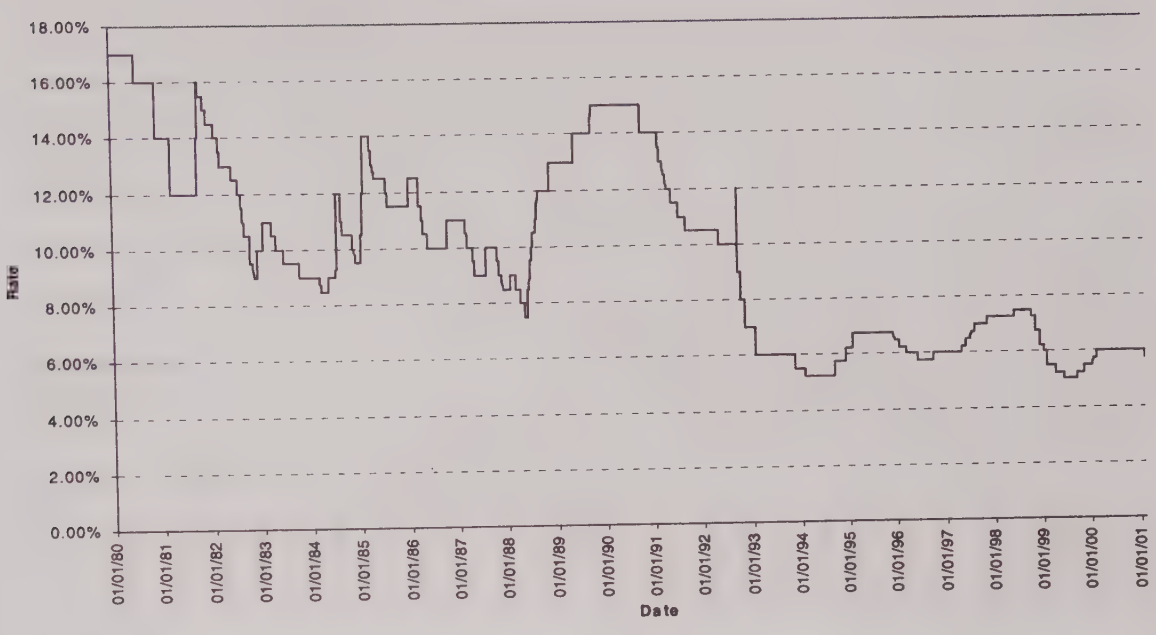
5.10 There is no need for statutory reform of the practice under the equitable jurisdiction. (Paragraph 4.65)

5.11 Readers are asked for any comments and evidence they may have about the benefits and costs of our proposals, including their main practical and economic impact upon different interests. (Paragraph 4.66)

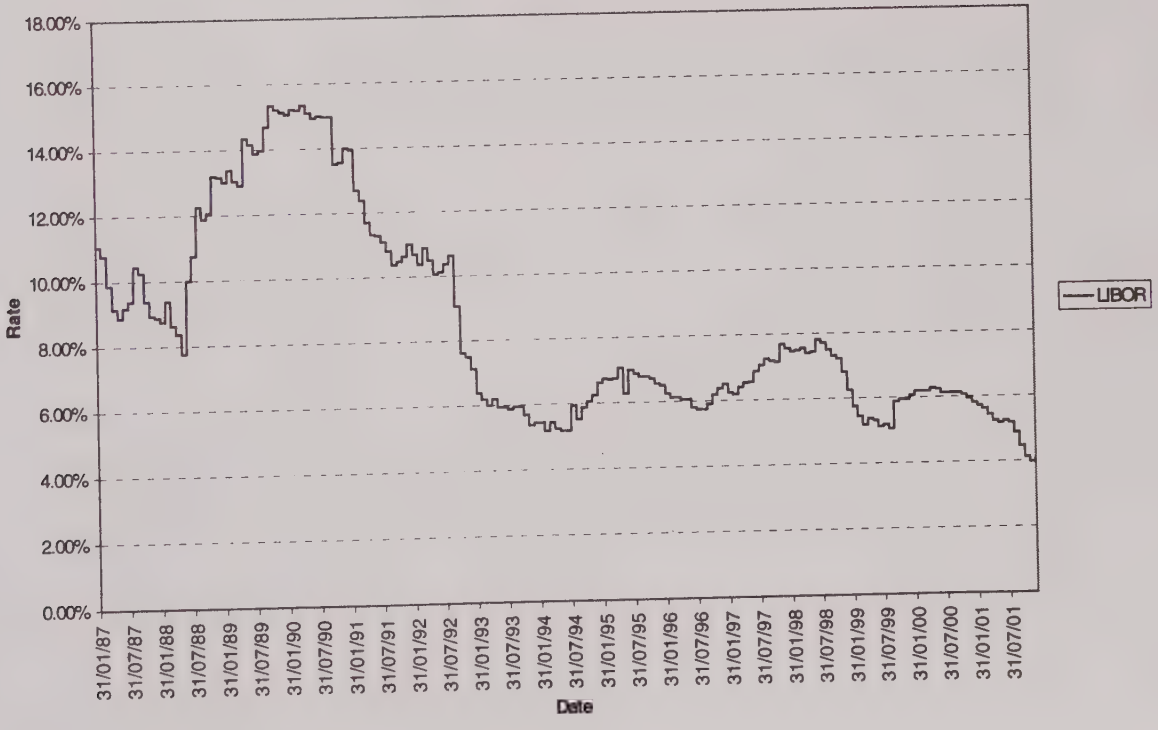
APPENDIX A
TABLES

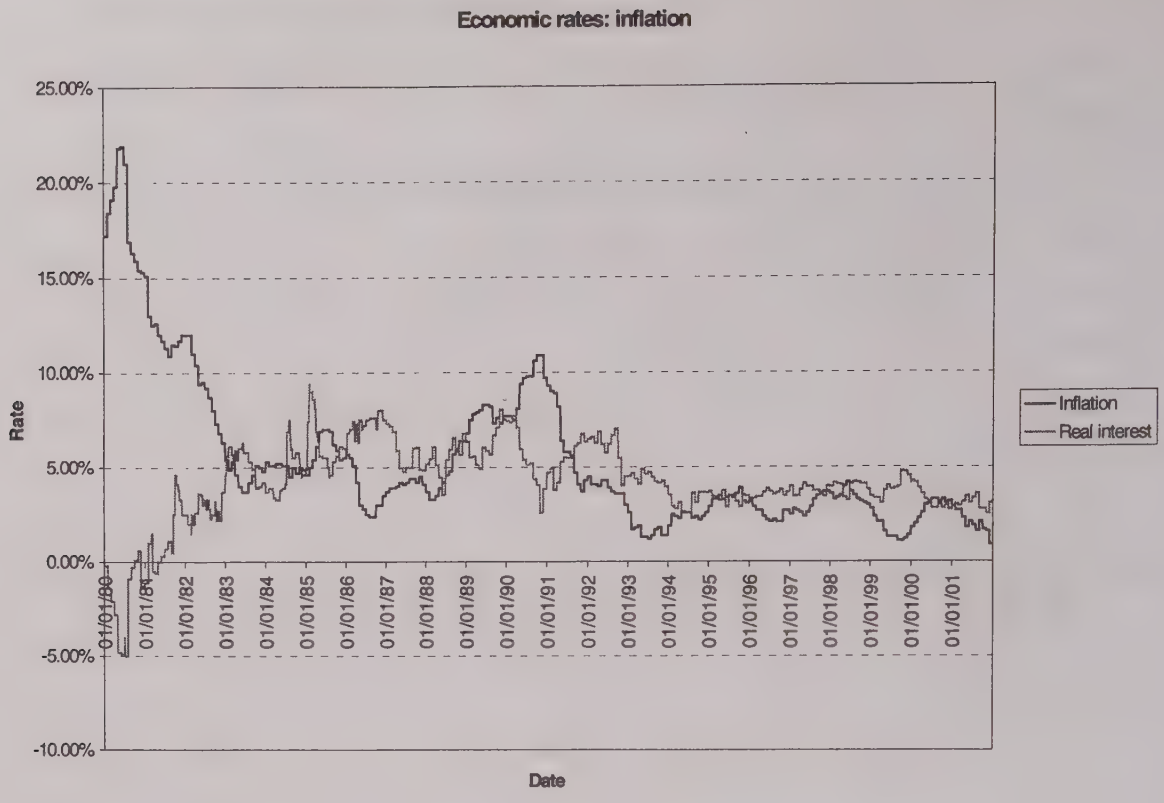


Economic rates: bank base rate



Economic rates: 3-month LIBOR




Economic rates: inflation
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
-5.00%
-10.00%
Rate
01/01/80
01/01/81
01/01/82
01/01/83
01/01/84
01/01/85
01/01/86
01/01/87
01/01/88
01/01/89
01/01/90
01/01/91
01/01/92
01/01/93
01/01/94
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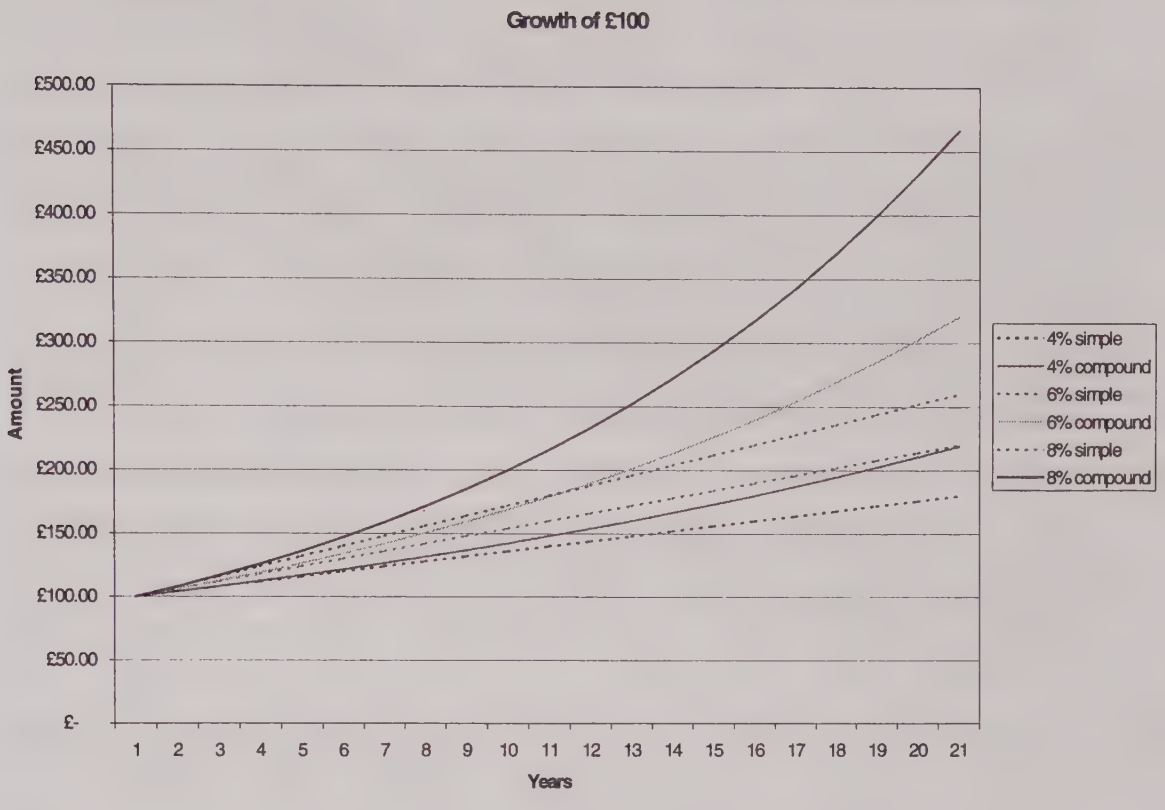
01/01/01
Date
Inflation
Real interest



The table referred to in paragraph 4.17, showing the number of years it takes for growth at compound interest at a lower rate to overtake growth at simple interest at a higher rate, for each pair of rates from 4 per cent to 8 per cent

	4% simple	5% simple	6% simple	7% simple	8% simple
4% compound	1	12	21	28	33
5% compound		1	9	15	19
6% compound			1	7	11
7% compound				1	5
8% compound					1

APPENDIX B
VARIATION IN DISPOSAL TIMES

B1 In paragraph 4.14, we discuss how the use of compound interest rather than simple interest would have the greatest effect in the longest-running cases. For example, the total interest produced by a 7 per cent compound rate would exceed the interest produced by an 8 per cent simple rate after five years. After 10 years, it would produce one fifth more in interest. It is therefore useful to examine the available statistical evidence to consider which types of action are most likely to be long-running, in the sense of involving delays of five years or more between the cause of action arising and the payment of damages or debt.

B2 Evidence on the duration of cases is patchy. The Judicial Statistics provide information on waiting time for trial, as measured from the issue of proceedings to the start of trial.[1] They do not, however, provide information about delays occurring before proceedings are issued. Nor do they give any indication of the duration of cases that settle after the issue of proceedings but before being set down for trial.

B3 There are, however, several ad hoc studies that add to our understanding of delay within the Civil Justice System. A key study was conducted by Professor Genn for the Woolf enquiry in 1996.[2] This looked at the cost and duration of cases submitted to the Supreme Court Taxing Office (SCTO). At the time, the SCTO dealt with High Court cases where the losing party wished to challenge the winning party's costs. The sample therefore included many expensive and contentious cases. Although these cases are not necessarily typical of litigation as a whole, they provide an important insight into difficult and long-running disputes.

B4 Genn found substantial differences between case types. As measured from first instructions to conclusion of case, the longest-running cases were medical negligence (mean 65 months), followed by personal injury cases (56 months) and professional negligence cases (41 months). The most rapidly concluded cases were judicial review cases (12 months), bankruptcy/companies court cases (13 months) and commercial cases without a claim value (16 months). The study also found that average case duration was significantly longer where the winning party had legal aid. The longest waits were therefore experienced by legally aided claimants bringing medical negligence claims (mean 66 months), personal injury claims (60 months) and professional negligence claims (52 months).

B5 This study is limited in that it looked only at delay from when the claimant first approached a solicitor. For most types of litigation, little information is available about delays from cause of action to legal instructions. In the case of personal

[1] In 2000, the waiting period from issue of claim to start of trial in county courts was 74 weeks. In the High Court Queen's Bench Division the waiting period (as measured from issue to trial or conclusion of case after setting down for trial) was 174 weeks: *Judicial Statistics Annual Report 2000* (2001).

[2] H Genn, *Survey of Litigation Costs* (1996).

injury litigation, however, studies suggest that most clients visit a solicitor within six months of the accident.[3]

B6 Studies of legally-aided litigation have confirmed that claims for serious medical negligence, some severe personal injuries and professional negligence can result in considerable delay. A detailed study of legally-aided personal injury claims concluded that medical and work (especially industrial disease) cases lasted substantially longer than road, pavement "trip" or occupiers' liability cases. It also found that case duration increased with severity of injury, with severe injury cases taking twice as long to resolve as minor injury ones.[4] A study of legally-aided general litigation confirmed that delays were a particular problem with professional negligence claims. The mean delay experienced by successful legally-aided professional negligence claimants was 50 months. Similar delays also occurred in actions against the police.[5]

B7 Finally, the research conducted for us by Professor Genn in 1994 explored the consequences of delay for personal injury victims.[6] The study found that the larger the claim, the longer the delay. Delay caused the greatest problems for victims receiving compensation of £100,000 or more, a third of whom waited at least 6 years from the accident to settlement.[7] These were the victims most likely to have accumulated debts in the aftermath of the accident: a fifth had borrowed £5,000 or more, and 7 per cent had borrowed £10,000 or more.[8] It is worth observing that accident victims in the study had often borrowed at relatively high rates of (compound) interest, relying particularly on credit cards and bank loans.

B8 All the studies cited preceded the civil justice reforms introduced in 1998 as a result of Lord Woolf's report on Access to Justice. The reforms were designed to reduce delay. Reforms in the way legal aid is administered also aim to encourage the swift and focused resolution of cases.[9] It may be therefore the case that in future delays will be reduced, though it is still too early to assess the effect of these reforms on long-running cases. It is not possible to estimate the number of future cases that will involve delays of over five years between cause of action and conclusion. It is also clear that any case may involve substantial delays.[10] However,

[3] See *Personal Injury Compensation: How Much is Enough? A study of the compensation experiences of victims of personal injury* (1994) Law Com No 225 p 70. Even in the largest claims (over £100,000) only 20% of claimants waited more than six months before consulting a solicitor. See also Harris et al, *Compensation and Support for Illness and Injury* (1984) p 105.

[4] P Pleasence, *Personal Injury Litigation in Practice*, Legal Aid Board Research Unit (1998).

[5] T Goriely and P Das Gupta, *Breaking the Code: The Impact of Legal Aid Reforms on General Civil Litigation* (2001).

[6] *Personal Injury Compensation: How Much is Enough? A study of the compensation experiences of victims of personal injury* (1994) Law Com No 225.

[7] *Ibid*, at p 71.

[8] *Ibid*, at p 152.

[9] In particular, the Funding Code introduced in April 2000 encourages solicitors to monitor progress on cases and re-evaluate the chances of success at different points in the system.

[10] For example in the SCTO sample, although half of all bankruptcy and company cases were resolved within 7 months, the longest case took 118 months. While half of liquidated commercial claims took 20 months or less, the longest case took 100 months.

previous studies suggest that the greatest effect of awarding compound rather than simple interest would be felt in medical negligence claims, in other large personal injury claims and in claims for professional negligence, especially where the claimant is relatively impecunious. Commercial litigants seem to be better placed to resolve their disputes within a few years.

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